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ADMINISTRATION'S FISCAL YEAR 1990 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE AND THE U.S. TAX COURT

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

APRIL 4, 1989

Serial 101-36

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ADMINISTRATION'S FISCAL YEAR 1990 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE AND THE U.S. TAX COURT

TUESDAY, APRIL 4, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
WEDNESDAY, MARCH 22, 1989

PRESS RELEASE #5
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
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THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING
TO CONSIDER THE ADMINISTRATION'S FISCAL YEAR 1990
BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE
AND THE UNITED STATES TAX COURT

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to examine the adequacy of the Administration's fiscal year 1990 budget proposals relating to the staffing levels and allocation of resources for the Internal Revenue Service (IRS) and the U.S. Tax Court. In addition, the Subcommittee will review the impact of fiscal year 1989 funding levels on current IRS operations.

The hearing has been scheduled for Tuesday, April 4, 1989, beginning at 9:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building. Witnesses invited to appear at the hearing include: the Honorable Richard G. Darman, Director of the Office of Management and Budget; the Honorable Michael J. Murphy, Acting Commissioner of the Internal Revenue Service; the Honorable Arthur L. Nims III, Chief Judge of the United States Tax Court; the Honorable Lawrence B. Gibbs, former Commissioner of the Internal Revenue Service; and, representatives of the General Accounting Office and the National Treasury Employees Union.

In announcing this hearing, Chairman Pickle stated: "As in the past, the Subcommittee will review the adequacy of the Administration's budget proposals for the Internal Revenue Service. We'll be especially interested to see whether the Administration's proposal adequately funds taxpayer services, examination and collection activities, and computer services.

"While the fiscal year 1990 IRS budget proposes a $289 million increase over the fiscal year 1989 funding level, it is highly unlikely that this increase will be sufficient for reasons relating to both fiscal year 1989 and fiscal year 1990. During fiscal year 1989, the IRS will have absorbed over $350 million in unfunded cost increases. Further, in fiscal year 1990 there will be approximately 3.2 million new taxpayers and 5.2 million additional tax returns filed. On top of this, Congress gave the IRS major new responsibilities under the Omnibus Anti-Drug Abuse Act of 1988, the Taxpayer Bill of Rights, and the Technical and Miscellaneous Revenue Act of 1988.

"As a necessary part of its review, the Subcommittee will consider the impact which the fiscal year 1989 funding shortfall is having on current IRS operations. The Subcommittee has already begun to receive reports that supplies are being rationed, travel has been curtailed, and a hiring freeze may be impeding adequate staffing. This may be due, in part, to the Administration's failure to approve IRS request for $170 million in fiscal year 1989 supplemental funding for activities such as correspondence training, improving taxpayer service accuracy, expert witness fees, tax publications, and stabilizing the returns processing work force.

"Serious concerns have arisen, and questions continue to be raised, about whether the IRS has been shortchanged. Taxpayers nationwide deserve better. I intend to start the hearing with a review of the policies and views of the Office of Management and Budget. I think that the facts will speak for themselves."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, May 12, 1988, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

SEE FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Chairman PICKLE. We will ask the subcommittee to please come to order. We have an important hearing today and I believe we will proceed now, so that we will have time to hear all the witnesses.

Today, the subcommittee will hear testimony about the administration's budget proposals for the Internal Revenue Service and the U.S. Tax Court for fiscal year 1990. We have invited, as witnesses, representatives from the IRS and the Tax Court, the General Accounting Office, and the National Treasury Employees' Union, together with former Commissioner of the Internal Revenue Service, Mr. Lawrence Gibbs.

And because the level of IRS funding has been the subject for dispute between the IRS and the Office of Management and Budget, we have also invited the Director of OMB, but I understand that OMB chose not to come. We will hear from them later.

We cannot really assess the adequacy of the administration's budget request for the IRS unless we look at the agency's condition at the end of fiscal year 1989. From all accounts we have received it looks like the IRS will not be in very good shape at the end of this fiscal year.

Internal Revenue Service has had to absorb $350 million in unfunded cost increases. Already shortchanged, the agency had to take on the new duties and responsibilities included in last year's drug bill, and in the Technical and Miscellaneous Revenue Act. We did not give the agency any money to fund these responsibilities.

Last year, short on funds, the IRS went to OMB to request a supplemental appropriation of $170 million. Supplemental funds would have gone to improve the accuracy of taxpayer services, to the combined annual wage reporting program, to expert witnesses' fees, and for tax publications.

OMB said no, and the result, we have heard, is that IRS is already beginning to experience the effects of a severe budget crunch. There is a freeze on hiring; supplies have been rationed; training has been curtailed; expert witness fees have been exhausted; audits of large corporations have slowed down; and travel has been curtailed. And the fiscal year is hardly half over.

At the end of fiscal year 1989, then, it looks like the Internal Revenue Service is going to be a hungry agency, and the administration's proposed 5.5 percent budget increase just does not seem adequate, or realistic to me. This amount will not even make up for the unfunded cost increases which the IRS has had to absorb in fiscal year 1989. The agency had itself requested $1.3 billion more, and over 13,000 more employees than OMB had requested from the Congress.

I am not sure that the administration fully appreciates the need to fund the IRS at an appropriate level. I wonder if any administration really understands the significance of that. The Internal Revenue is, after all, the primary revenue-collector for the Federal Government. Next year, the agency is expected to collect $1.1 trillion. Giving the IRS more money does not contribute to the budget deficit since the increased investment is more than offset by increased tax receipts.

In addition, I am somewhat troubled by the administration's priorities for the IRS. The President's budget has a new IRS enforcement initiative calling for additional examiners, revenue officers,

collection agents and clerical employees. These additional employees will conduct simple return audits, perform door-to-door collection efforts, and cross-check IRS and Social Security records to catch unreported income.

At the same time that it proposes to step up these rather simple yet important collection efforts, the administration proposes staffing decreases in the Examination Division, the Appeals and Tax Litigation Division, the Employee Plans and Exempt Organizations Division, and the Tax Fraud Investigations Division.

These divisions handle some of the more complicated tax problems. They deal with complex cases like money laundering, tax shelters, and tax havens. These cutbacks have been proposed despite the fact that the audit rate has fallen by almost 50 percent during the last decade.

I cannot help wondering whether reduced staffing for these IRS functions will not offset some of the revenue gains the administration expects to reap from the beefed-up collection efforts proposed in the enforcement initiative.

In addition, it looks like we are going to beef up collection efforts for "Joe Sixpack," while cutting back on enforcement efforts for the "champagne set."

Now that is a broad rationalization, or concern that I have expressed, but we have real difficulties ahead of us in the area of proper budgeting for this important agency. I think we have got to be more realistic about it, and this testimony today is going to be very important to put on the record what you think are the needs and what you think will be the needs.

Now let me ask Mr. Schulze if he has any opening remarks.

Mr. SCHULZE. Yes. Thank you, Mr. Chairman. I am pleased to join you in opening our hearing on the fiscal year 1990 budgets of the Internal Revenue Service and the U.S. Tax Court.

The fiscal year 1990 budget request for the IRS is almost $5.5 billion, and covers 115,000 employees. This is about $300 million, or 5.5. percent higher than the 1989 IRS budget. It also would represent an increase of 2,000 full-time employees.

Mr. Chairman, we have all read the budget numbers which the administration has submitted. Today, we should learn the story behind the numbers. The fiscal year 1990 figures of $5.5 billion and 115,000 employees cannot be evaluated in a vacuum.

We should evaluate the budget request in comparison to the responsibilities and the mission of the IRS. On its face, the increase in the IRS budget appears to be in line with an adjustment for 1 year's worth of inflation, but the increase really may be less meaningful than it appears.

For example, in fiscal year 1989, the IRS had to absorb at least $359 million in unfunded costs. This includes a $105 million shortfall in the fiscal year 1989 appropriation, and $250 million to cover pay raises, higher pension and health-benefit costs, and increased postage charges.

Furthermore, the IRS workload has increased since last year. In 1990, the IRS will process 196 million tax returns and 13 million supplemental documents. This is an increase of 6 miliion documents.

Finally, Congress has passed new laws in late 1988 which have increased the IRS's workload. The Omnibus Anti-Drug Abuse Act of 1988 increases the role of the IRS in tracking money-laundering and currency reporting. The Technical and Miscellaneous Revenue Act of 1988 will require the IRS to spend time implementing its many highly technical features.

One portion of this act is popularly known as the Taxpayers' Bill of Rights. I personally applaud this long-needed taxpayer protection, but, Mr. Chairman, this illustrates that the IRS workload has increased for two reasons.

First, even under the old law, the natural growth in the economy results in more tax returns being filed, and more requests for assistance. Second, recently passed new laws have increased the responsibilities of IRS. We should bear this in mind when we evaluate the IRS budget for fiscal year 1990.

The fiscal year 1990 budget for the U.S. Tax Court should be a much happier review. The Tax Court's budget request has decreased by over $1 million in comparison to last year. The decrease appears to be related to a reduction in some nonrecurring building maintenance costs. In addition, the caseload of the Tax Court is decreasing, and this trend is encouraging.

Mr. Chairman, I want to learn more about the fiscal year 1990 budgets of the IRS and the Tax Court. Our witnesses can give us a candid analysis of the budget picture. I look forward to receiving today's testimony.

Chairman PICKLE. Our first witness this morning——

Mr. DORGAN. Mr. Chairman.

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Mr. Chairman, I will be very brief, but let me thank you for holding these hearings, and, as a matter of background remind the committee, and others, once again, that a task force has done a substantial amount of work in this area.

A bipartisan group of former Commissioners of the Internal Revenue Service, Treasury officials, and others, has analyzed the so-called tax gap—that is, the money that is owed the Federal Government but not able to be collected, in fact not even reported—what should we do in terms of investment in our tax-collecting system to narrow that tax gap?

At a time when people talk about the need for new revenue, the question is how do we better collect the revenue that ought to be collected today? I think the Internal Revenue Service has done an awfully good job in the last couple of years in turning around what had been a pretty difficult situation at the Service.

But I might say that one of the interests I have in these hearings is in trying to analyze which faceless, nameless folks down at OMB, or somewhere else deep in the bowels of the administration, has made judgments in the decade of the 1980's that has put us in the position of losing tens of billions of dollars.

Mr. Chairman, it was interesting that when we had the savings and loan hearings not too long ago in the committee, we were told by the folks who head the various agencies, that when deregulation occurred in the financial industries, and there was clearly a need for more people to monitor, and to evaluate and to audit, OMB said no. The result of that decision was apparently that we are going to

be up to our elbows here in 100 billion dollars' worth of problems because OMB said no new auditors.

A question with respect to funding the Internal Revenue Service, and the question about budgets, and how many audits they can do, and how much they can affect on the collection side, and others, is a relevant topic for this subcommittee. Particularly, it should be of interest for us to determine who is making decisions with respect to staffing levels and budgets at OMB, and what has been the quality of those decisions, and have they impacted on the Service, and the revenues that this country receives.

So, Mr. Chairman, I intend to inquire into a number of these areas, and I thank you very much for calling these hearings because I think they are very important.

Chairman PICKLE. Thank you, Mr. Dorgan. Do any other members wish to speak?

[No response.]

Chairman PICKLE. Our first witness this morning is the Acting Commissioner of the Internal Revenue Service, Michael Murphy, and with him is John Wedick, Deputy Commission for Planning, and Charles Brennan, Deputy Commission for Operations.

Mr. Murphy, we will ask you to proceed, and we thank you for being with us this morning.

STATEMENT OF HON. MICHAEL J. MURPHY, ACTING COMMISSIONER, U.S. INTERNAL REVENUE SERVICE, ACCOMPANIED BY JOHN L. WEDICK, JR., DEPUTY COMMISSIONER FOR PLANNING AND RESOURCES; AND CHARLES H. BRENNAN, DEPUTY COMMISSIONER FOR OPERATIONS

Mr. MURPHY. Thank you, Mr. Chairman. Good morning.

You have already introduced Mr. Wedick and Mr. Brennan. Let me also mention that behind me are various Assistant Commissioners, the Taxpayer Ombudsman, our Associate Chief Counsel, Rich Mihelcic, and our Finance Director, Steve Taylor.

I am here today, Mr. Chairman, to discuss the proposed IRS budget for fiscal year 1990. I will cover what we, at IRS, with the support of Congress, plan to accomplish in 1990, and what our concerns are in 1989. I also intend to review, briefly, the current status of the filing season.

Mr. Chairman, I would like to begin by setting the stage, by noting that the administration and Congress have had to make difficult decisions, and will continue to have to make them in this era of budgetary constraints.

Our fiscal year 1990 budget request reflects an appropriate amount under these circumstances. At the same time, it shows that we do not intend to retreat from the commitment we have made to provide quality service to the American taxpayers.

I emphasize that IRS remains committed to the concepts of quality and excellence. We appreciate the subcommittee's interest and assistance in supporting these priorities. I assure you of our cooperation in working with the subcommittee to ensure the continued improvement of the IRS's administration of tax laws.

For your convenience, Mr. Chairman, I would like to summarize my written statement, and tell you where I am, as I go along.

Maintaining a balance between service to taxpayers and enforcement of our tax laws continues to be our objective. The fiscal year 1990 budget carries forward this notion of balance between the two.

As you indicated, Mr. Chairman, the fiscal year 1990 request is for $5.5 billion, and 115,110 average positions, which would be an increase of $289 million and 2,052 average positions over fiscal year 1989.

This increase is required to cover certain unavoidable cost increases and workload growth. Our first priority, Mr. Chairman—and I am on page 4 of my testimony—is to maintain current program levels and address workload increases.

I would like to give you, Mr. Chairman, a picture of what we expect to do in 1990. I have a chart up here on my right which indicates the same information. It illustrates what we expect to accomplish in fiscal year 1990 with the budget that we propose.

The first figure, Mr. Chairman, is our plan to process 196 million tax returns, which compares with 190 million returns for last year, fiscal year 1989.

We project collecting over $1.1 trillion in gross revenue, and estimate we will issue 84 million tax refunds totaling $107 billion.

We will process, Mr. Chairman, 1 billion information return documents, and examine 1.5 million tax returns. We will collect 3 million delinquent accounts, and secure 4.4 million delinquent returns.

Mr. Chairman, we will project responding to 68 million taxpayer service requests for information. This of course includes toll-free telephone calls, walk-in service, Teletax, other types of service to taxpayers.

Let me give you our three priority areas for 1990, which this budget emphasizes: one, modernizing our tax system; two, providing better service to taxpayers; and three, improving tax enforcement.

Let me tell you a little bit, Mr. Chairman, about modernizing our tax system. That information is contained on page 5 of my testimony.

IRS's fiscal year 1990 budget provides for essential investments in modernizing our computerized tax-processing systems. Modernization and increased capacity are of critical importance as we move into the 1990's, and our workload continues to grow. Sustained funding is needed to plan, procure, and install the redesigned system we envision, one to support the needs of the IRS in the 1990's and beyond. Also one, Mr. Chairman, that is going to be more responsive to the taxpayers we serve.

Under the current system, many steps in the processing of a tax return are done manually, resulting in errors. Automating these processes will result in fewer errors, and allow us to be more responsive to taxpayers.

Tax system modernization is an administration priority, and fiscal year 1990, Mr. Chairman, is a key year for this effort. Design and procurement projects for future systems depend on fiscal year 1990 funding. Important elements providing needed capacity relief are also at the solicitation stage and require startup funding.

On page 7 of my testimony, Mr. Chairman, I make the point that one of the features of our approach in planning for modernization is that projects will be phased in over the next 10 years.

This will minimize the impact on existing systems. You have already seen the fruit of some of our efforts—electronic filing is one project that has become operational, and its use is rapidly expanding. More taxpayers are taking advantage of electronic filing and receiving their refunds sooner, within an average of 19 days, Mr. Chairman. We are pleased by the 3.2-percent processing error rates as well.

My testimony, Mr. Chairman, includes some examples of other modernization efforts that are underway, and these are covered on pages 8 and 9. I am not going to go into the detail of these projects, but only say to you that they are examples of how we plan to use information technology to provide more timely and better quality service to taxpayers.

Speaking of better service to taxpayers—on page 9 in my testimony, Mr. Chairman, I state our belief that providing assistance to taxpayers to help them meet their tax obligations continues to be one of our highest priorities.

We provide a balanced program of taxpayer services, the major component being our toll-free telephone system. For 1990, we plan to provide an 85-percent level of service and will answer about 38 million toll-free calls.

The demand, Mr. Chairman, is really increasing for our Teletax system which provides simple tax law and refund inquiry information through more than 100 recorded messages. In addition, we will continue our programs in understanding taxes, tax counseling for the elderly, and the Volunteer Income Tax Assistance Program, otherwise known as VITA.

On page 10 of my testimony, Mr. Chairman, I point out that the quality of assistance provided on our toll-free system is an area of continuing concern and emphasis, both by the Internal Revenue Service and by your subcommittee.

We have discussed with you previously how our integrated test call survey system works, and how it helps us to assess the courtesy, completeness, and accuracy of our responses to taxpayer inquiries. It also provides trend information, Mr. Chairman, which is indicating that the accuracy of our answers is improving as the filing season progresses.

As of April 1, the test call system shows that our assistors providing wrong answers that could result in taxpayers making an error on their returns 27.8 percent of the time. So 27.8 percent of the time a taxpayer could file an inaccurate return. However, assistors are meeting the standard for accuracy that IRS and GAO had previously agreed upon 63.7 percent of the time. Now of course we both agree that this is still an unacceptable level, but as I pointed out, Mr. Chairman, we are encouraged by recent improvements which indicate that our regional diagnostic centers are having a positive effect in this area.

Our budget request for fiscal year 1990 includes $55.9 million in funding to continue our effort to improve on the ability of our assistors, and to take those steps that we consider necessary to improve the quality and accuracy of our taxpayer assistance.

Our strategy is basically to improve training, and to stabilize our work force. I would like to emphasize that our Taxpayer Service personnel are contending with a very complex tax law that is con-

tinually changing from year to year. There have been 138 separate public laws which amended the Internal Revenue Service Code enacted since 1975, Mr. Chairman, 13 of them since the major tax reform legislation that was enacted in 1986. So complexity and change are the name of the game, but, as I indicated, I feel that we can cope with it given the support of your subcommittee.

On page 12 of my testimony, Mr. Chairman, I indicate that we recognize the magnitude of the challenge confronting us. I believe we are doing what needs to be done to improve the accuracy of our toll-free answers, and that these efforts have already begun to produce positive results.

Let me now talk a little bit about another high priority, which is improving tax enforcement.

Our budget request includes enforcement activity improvements that will result in additional estimated tax collections of $318 million in fiscal year 1990, at a cost of $54.9 million.

President Bush's priority programs include more than $70 million for IRS drug enforcement activities, which, again, you already pointed out, Mr. Chairman. Fourteen million dollars of that is being transferred to the Department of Justice for Organized Crime/Drug Enforcement Task Force activities. We participate, by the way, in two out of three Organized Crime/Drug Enforcement Task Force investigations.

On page 13 of my testimony, Mr. Chairman, I mention the fact that the processing of currency transaction reports, which trace transactions of deposits of over $10,000, is a significant part of our efforts to combat narcotics traffickers and money launderers.

In addition to our high level of participation in these special enforcement programs, we are implementing the Anti-Drug Abuse Act of 1988 for which IRS, along with Treasury and OMB, will be evaluating any resource implications.

As you pointed out, Mr. Chairman, we are unfunded on the Anti-Drug Abuse Act of 1988. Aside from the Anti-Drug Abuse Act, Mr. Chairman—I cover this on page 14 of my testimony, and as you have pointed out—there is other recent legislation that will have an impact on IRS operations. One of these bills is the Technical and Miscellaneous Revenue Act of 1988, which, as Congressman Schulze points out, includes the "Taxpayer Bill of Rights," and another is the Medicare Catastrophic Coverage Act of 1988. We are proceeding with implementing those laws, and are analyzing their resource impact on IRS.

Recent budget proposals include tax law changes for child care; energy tax incentives; and capital gains. If enacted, they, too, would have an impact on IRS operations and resources.

Let me now share with you a little bit about our 1989 concerns.

As you pointed out, and as I recently testified, the IRS is experiencing a tight budget situation for fiscal year 1989. We are absorbing such increased costs as pay, the postal rate increase, and sharply rising health and retirement contribution costs. Our financial plan for 1989 gives priority to ensuring that sufficient resources are available for taxpayer service and returns processing.

On page 15 of my testimony, Mr. Chairman, I mention that we are cutting back on expenditures for noncase related travel, for less essential training, and for acquisition of ADP equipment and sup-

plies. A hiring freeze is in effect for most occupations. We are deferring for 1 year office relocations and renovations, and are reducing telecommunications expenditures. We are mindful of the need, Mr. Chairman, of having minimal impact on our operations, and that is the stance that we are in right now.

The 1989 filing season, Mr. Chairman, which I gave you a briefing on in recent testimony requires an update.

The filing season, as I have testified before, is moving along quite successfully. We are extremely proud of the work that is being done by the employees of the Internal Revenue Service in handling the very difficult jobs of processing tax returns and responding to difficult questions.

Indications are, from our reviews, and the current data, that we will have another successful filing season for the Internal Revenue Service and for the taxpayers we serve.

As of March 24, Mr. Chairman—and this is covered on page 16 of my testimony—I gave you some updated figures. I can now also give you figures that carry us right on up until April 1.

Our data shows that we received 53 million returns as of March 24. That figure now, Mr. Chairman, is 58 million. I indicated that we processed over 42 million returns. We have now processed over 48 million returns.

We issued more than 31 million refunds, with an average refund of $816 as of March 24. As of right now those figures are 37 million refunds, and the average is up a few dollars, to $819. We have received, Mr. Chairman, approximately 1 million electronically filed returns, which as I indicated before, is certainly a sign of the future.

We have answered 13.1 million toll-free calls so far for this filing season, and we have received 15 million Teletax system calls, which is higher than what we projected, and if you notice on our chart, we project that figure is even going higher for fiscal year 1990.

So, in closing, Mr. Chairman—and this is covered on page 17 of my testimony—I would like to say that we believe we can meet our responsibilities in administering the tax system, even in these difficult times of Governmentwide fiscal constraints.

We remain committed to improving our responsiveness to our customers, and, at the same time, we want to maintain a balanced approach between service to taxpayers and enforcement of our tax laws.

Our budget will allow us to operate effectively next year. The requested increase would also enable us to make significant improvements in the three priority areas which I covered: tax system modernization, better service to taxpayers, and enhancement of the enforcement of tax laws.

I look forward, Mr. Chairman, to hearing your views and your concerns. Mr. Brennan, Mr. Wedick and I would be happy to answer any questions that you or other members may have. That concludes my opening remarks, Mr. Chairman.

[The statement of Mr. Murphy follows:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
STATEMENT OF
MICHAEL J. MURPHY
ACTING COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE
APRIL 4, 1989

Mr. Chairman and Members of the Subcommittee:

I am here today to discuss the proposed budget for the IRS for fiscal year 1990. In my testimony, I will cover what we at IRS, with the support of Congress, plan to accomplish in 1990 and what our concerns are in 1989. I also intend to briefly review the current status of the filing season. With me are Deputy Commissioners John Wedick for Planning and Resources and Charly Brennan for Operations.

COMMITMENT TO QUALITY

Mr. Chairman, I would like to begin by setting the stage for a discussion of the difficult decisions the Administration and the Congress have had to make and will continue to have to make in this era of budgetary contraints. Our FY 1990 budget request reflects an appropriate amount under these circumstances. At the same time, we do not intend to back away from the commitments we have made to provide quality service to our customers - the American taxpayers.

I want to emphasize today that we remain committed to the fundamental concepts of quality and excellence. We appreciate the Subcommittee's interest and assistance in supporting these priorities. By working together cooperatively, we can ensure that the IRS' administration of the tax laws continues to improve.

FY 1990 BUDGET OVERVIEW

As you are aware, the President's FY 1990 budget proposes freezing, at FY 1989 levels, the aggregate spending of domestic programs not directly associated with one of his five broad initiatives. Although our programs are included in this category, the president has emphasized that the freeze is flexible, allowing some programs to increase while others are reduced.

We expect that final decisions about whether to increase or decrease specific programs within this freeze category will be determined through top-level deliberations and negotiations between the Administration and Congress. Today, we are prepared to discuss a number of initiatives, program reforms and/or reductions to FY 1989 spending levels that were presented in the budget submitted in January.

It should be emphasized that the President has not proposed that funds be appropriated for these particular adjustments. Therefore, our dicussion must be viewed as providing the Committee with information on "candidate" areas which could be increased or decreased within the context of the overall freeze.

Maintaining a balance between service to taxpayers and enforcement of our tax laws continues to be our objective. The FY 1990 Budget carries forward this notion of balance. Our budget request totals 115,110 average positions and $5.5 billion, an increase of 2,052 average positions and $289 million over FY 1989. A significant portion of the requested increase in our budget proposal represents requirements to cover certain unavoidable cost increases and workload growth. These increases are offset to some extent by reductions resulting from operational savings and information systems project reductions.

As we look to 1990, gross tax collections will total over $1.1 trillion, with refunds totaling $107 billion. Our first priority is to maintain current program levels and address workload increases. In 1990, we will:

- Process 196 million tax returns,
- Issue 84 million tax refunds,
- Process 1 billion information return documents,
- Examine 1.5 million tax returns,
- Collect 3 million delinquent accounts
- Secure 4.5 million delinquent returns, and
- Respond to 68 million taxpayer service requests for information, including toll-free telephone calls, walk-in service, and recorded messages.

The 1990 budget emphasizes three high priority areas for the coming fiscal year. They are: 1) modernizing our tax system; 2) providing better service to taxpayers; and 3) improving tax enforcement.

1. Modernizing our Tax System

IRS' FY 1990 budget provides for essential investments in 1990 to continue modernization of our outdated computerized tax processing systems. Modernization of IRS' information systems and increased capacity is of critical importance as we move into the 1990s. Faced with a growing workload, we cannot meet those demands without modernizing and improving our information systems. We cannot make these improvements without the sustained funding needed to plan, procure and install new systems and equipment.

With our current system, many taxpayers call with account problems, only to be told that the information necessary to resolve their cases is available only at other IRS offices. The taxpayers must then follow up with letters in an attempt to resolve their problems. In 1988, 6.9 million notices were issued to taxpayers. We received 1.8 million contacts regarding these notices. After the redesigned system is operational, IRS will be able to help taxpayers at the first point of contact.

With our current system, a taxpayer who requests a copy of a tax return often has to wait up to six weeks. In 1988, copies of over 16 million returns were requested from the Federal Records Centers and another 21 million from IRS Service Centers. Under our redesigned system, electronically stored tax return information will be available immediately to IRS technicians for transmittal to taxpayers.

Under the current system many steps in the processing of a tax return are done manually with a great number of errors. Automation of these processes will result in a system less susceptible to error and allow us to be more responsive to taxpayers.

The Administration has recognized the priority of tax system modernization within the IRS budget and has made this a Presidential management priority. FY 1990 is a key year for this effort. Design and procurement projects for future systems depend on FY 1990 funding. Several of the key elements of the Tax System Modernization effort, such as the Service Center Support System, will provide some capacity relief for our existing systems. These efforts are now at the solicitation stage and require start-up funding in the FY 1990 budget.

Our approach in planning for modernization has been to develop a comprehensive management plan -- a master plan for redesigning the tax system to support the needs of the IRS in the 1990's and beyond. Thus, we are not only planning for the acquisition of new computer equipment, but we are also redesigning our information systems so that we can utilize state-of-the-art equipment in responding to taxpayers, much like the leading private sector financial institutions now respond to their customers.

Our master plan outlines the vision of what we would like our system to look like in the 1990's. The plan, which has been reviewed by both Treasury and OMB, details the responsibility and authority of IRS personnel for this project; it outlines our procurement strategy, our telecommunications strategy, and transition plans for various components of the new system.

Many of these projects are now underway. One of the key features of our modernization efforts is that projects will be phased in over the next ten years. Rather than implementing a new system all at once, we have chosen this approach to minimize the impact that new systems will have on existing systems. You have already seen the fruit of some of our efforts. Electronic filing is one project that has become operational and continues to be a success.

As of March 24 this year, about one million returns had been filed electronically compared to just under 600,000 electronically filed returns for all of last year. Those taxpayers who have taken advantage of electronic filing are receiving their refunds much sooner -- within an average of 19 days, which is three to eight weeks sooner than for paper returns. Moreover, returns filed electronically are processed with a much lower frequency of errors -- a 3.2 percent error rate compared to the error rate on paper tax returns of 16.3 percent.

Let me give you several examples of some of the other projects that are underway:

The Document Processing System--Rather than process and store paper tax returns, IRS would use optical imaging technology. When filed, a paper return would be "imaged" before processing. The imaged return would be processed and converted to machine readable form for use in automated processing. In addition, IRS employees would work from the imaged return rather than the paper return for other operations such as Examination and Collection of taxes. Storing and retrieving images rather than paper will be more efficient and cost effective.

Automated Underreporter--The Underreporter Program was established to identify discrepancies between items of income reported on income tax returns submitted by taxpayers and the corresponding information returns submitted by employers, banks, and other payors. Using an on-line computer system, the Automated Underreporter System will enable us to compare the information without requesting paper copies of returns and related documents. This will reduce paperwork by automating tax account research and the generation of notices related to discrepancies.

The On-Line Entity Project--This will put certain identifying data from the tax return such as the taxpayer's name, Social Security number, and address on an on-line computer system. Currently, this data must be researched through our tape driven systems. By placing it on line, service centers will be able to immediately correct inaccurate identifying data, thus greatly reducing the number of unpostable cases. In addition to more timely and accurate posting of taxpayer account information, the lower unpostable inventories will be easier to manage, and will require less physical space and computer capacity.

Let me emphasize that these modernization efforts are more than simply replacing outdated and inefficient computerized systems. As we develop new systems configurations and replace overburdened equipment, we are also searching for and identifying ways to use information technology to provide more timely and better quality service to taxpayers.

2. Providing Better Service to Taxpayers

Providing assistance to taxpayers to help them meet their tax obligations continues to be one of our highest priorities. In order to do this effectively, we provide a balanced program of taxpayer services. The major component of our program continues to be our toll-free telephone system. For 1990, we will answer some 38 million toll-free calls and will provide an 85 percent level of service. I am pleased to say that we will also be continuing our programs in Understanding Taxes, Tax Counseling for the Elderly, and Volunteers in Income Tax Assistance.

The tele-tax system provides simple tax law and refund inquiry information to taxpayers through more than 100 recorded telephone messages, freeing up taxpayer assistors to answer more complex technical tax law inquiries and resolve tax account problems. Some 14 million tele-tax calls will be answered in FY 1990. This year we have already surpassed this projection. Funding for additional circuitry for tele-tax processors will enable us to handle even more tele-tax calls in the future. The separate toll-free service already established for ordering tax forms and publications from three centralized distribution sites will also be continued.

We still need to do more to improve the accuracy and the overall quality of our service to taxpayers. The quality of assistance provided on the telephone system is an area of continuing concern and emphasis. We have worked closely with GAO to refine our Integrated Test Call Survey System to assess the courtesy, completeness and accuracy of the responses to taxpayer inquiries. The system allows us to identify those areas of tax law that need to be emphasized in training, as well as those offices that need particular assistance. It also provides information on trends in our technical responses. Trend information seems to indicate that the accuracy of our answers is improving as the filing season progresses.

Our budget request for fiscal year 1990 includes $55.9 million to provide the funding necessary to continue our effort to improve on the ability of our assistors to do just that. Our strategy is basically to improve training and to stabilize our workforce by making more of our temporary employees permanent and by upgrading some of our taxpayer service representatives to taxpayer service specialists. This requires an increase of 1300 positions. In addition, we are testing an automated taxpayer service system prototype in our Dallas district, which will make research materials more available to our assistors. This year we have 40 automated work stations in operation. We will continue our efforts in this area.

I would like to emphasize that our taxpayer service personnel are contending with very complex tax law. There have been 138 separate public laws which amended the Internal Revenue Code since 1975. There have been 13 new laws since the Tax Reform Act of 1986. You can see the magnitude of the challenge confronting us to recruit and retain personnel able to deal with the complexity of ever-changing tax laws.

I believe we are doing what needs to be done and I believe that these efforts have already begun to result in improved accuracy of our toll-free answers.

3. Improving Tax Enforcement

The third area I would like to emphasize is our proposed improvements to tax enforcement activities.

A. Selected Tax Enforcement Activities

Our budget request includes improvements to selected tax enforcement activities that will result in additional estimated tax collections of $318 million in fiscal year 1990, at a cost of $54.9 million. These increased revenues will result from additional correspondence audits, closing additional unpaid tax accounts, expanding our tax compliance programs overseas, reconciling wage reports and ensuring compliance with the requirement that Social Security numbers be reported for all dependents age 5 or older (age 2 or older for returns due after December 31, 1989).

B. Drug Enforcement

President Bush's priority programs include slightly over $70 million for IRS drug enforcement activities, of which $14 million is being transferred to the Justice Department for Organized Crime Drug Enforcement Task Force (OCDETF) activities.

As you are aware, the IRS is a major partner in the war against drugs. We participate in two out of three OCDETF investigations. In FY 1988, 765 OCDETF investigations were initiated. Since 1983, IRS has recommended 3,500 prosecutions and obtained 2,856 indictments and 2,089 convictions.

The processing of currency transaction reports, which are required on transactions in currency over $10,000, is a significant part of IRS's efforts to combat narcotics traffickers and money launderers. We will devote $15 million to processing currency transaction reports in FY 1990.

We have a high level of participation in these special enforcement programs. We are undertaking new responsibilities under the Anti-Drug Abuse Act of 1988, for which IRS, along with Treasury and OMB, will be evaluating any resource implications.

RECENT AND PROPOSED LEGISLATION

Aside from the Anti-Drug Abuse Act of 1988, recent passage of the Technical and Miscellaneous Revenue Act of 1988, which includes the Omnibus Taxpayer Bill of Rights, and the Medicare Catastrophic Coverage Act of 1988 will have an impact on IRS operations. We are proceeding with implementing those laws and are in the process of analyzing the resource impact of this new legislation.

In addition, the recent budget proposals made by President Bush include tax law changes for child care, energy tax incentives, research and experimentation, enterprise zones and capital gains. If these are enacted, they would have an impact on IRS operations and resources.

FY 1989 CONCERNS

You are aware that we at IRS do have a tight budget situation this year. We are absorbing a number of increased costs, including pay, the postal rate increase that went into effect last spring and sharply rising health and retirement contribution costs. To provide adequate service to taxpayers we are also redirecting funds to taxpayer service and returns processing. Our financial plan for FY 1989 gives priority to ensuring that sufficient resources are available for these programs.

We are cutting back expenditures on non-case travel, less essential training, acquisition of ADP equipment and supplies. A hiring freeze is in effect for most occupations. We are deferring for one year office relocations and renovations, and reducing telecommunications expenditures.

1989 FILING SEASON

The 1988 filing season presented special challenges for the IRS as we began implementation of the Tax Reform Act of 1986. I am happy to report that we successfully met that challenge, and this year have dealt successfully with the effect on the filing season of ongoing implementation of the Tax Reform Act and more recent legislation.

The 1989 filing season also is going smoothly. As we have done in the past, we prepared for the filing season, among other ways, by using a national office/field office executive committee to review plans for, and the readiness of, every operation involved in carrying out a successful filing season.

Our preparations have ensured the prompt processing of tax returns and issuance of refunds. As of March 24, 1989, we have processed over 42 million returns and issued more than 31 million refunds, which is ahead of last year's pace. Service center inventories remain at manageable levels. In addition, the number of individual returns filed electronically is more than twice the number of returns filed electronically by this time in 1988 and has passed the 1 million mark.

We have also not experienced any significant delays in filing orders for forms this year. Forms and publications needed for the filing season have generally been available.

Demand for our toll-free assistance is at the level we has anticipated. Through March 25, 1989, we had answered 13.1 million calls compared to 13.9 million for the comparable period last year. We expect to answer close to the number of calls we responded to in FY 1988, 38.5 million calls, while still meeting our goal of providing an 85 percent level of service. In addition, 15 million taxpayers have used our tele-tax system this year compared to 5 million one year ago.

Our reviews and these data indicate that 1989 will be another successful filing season for the IRS.

CLOSING

We believe we can perform our responsibilities in administering our nation's tax system, even in these difficult times of Government-wide fiscal constraints. We do not intend to backtrack on the commitment we've made to improving our responsiveness to the public. Nor will we swerve from the clear direction we have taken to maintain a balanced approach between service to taxpayers and enforcement of our tax laws.

Internal Revenue Service Program Responsibilities

	FY 1990
Tax Returns Processed	196 Million
Information Returns Processed	1.0 Billion
Refunds Issued	84 Million
Taxpayers Assisted	68 Million
Returns Examined	1.5 Million
Delinquent Accounts Collected	3.0 Million
Delinquent Returns Secured	4.5 Million
Gross Revenue Collections	$1.1 Trillion
Refunds	$107 Billion
Net Tax Revenues	$993 Billion

INTERNAL REVENUE SERVICE
ALLOCATION OF ADDITIONAL FUNDING
FISCAL YEAR 1990

Specific Questions from the Subcommittee on Oversight, Committee on Ways and Means

1. How the IRS would allocate additional funding in FY 1990 over 1989 levels, along with yield-to-cost at each level, for the following levels: $10 million, $25 million, $50 million, $100 million and $150 million.

Answer: The budget, as recommended by the President, already proposes an increase of $289 million for the Internal Revenue Service in FY 1990, above the level currently authorized for FY 1989. The budget, if approved, would provide improved service to taxpayers, funds for ADP and systems modernization, and expanded tax enforcement, with additional revenue collections of $318 million.

If additional resources were made available, above the level requested for FY 1990, IRS would allocate the funds as follows:

--restoration of reductions required to support increased pay and benefit costs, $91.5 million in budget authority.

This amount would be used to restore otherwise permanent Servicewide reductions that are being taken beginning in FY 1989 in: overtime, travel, training, equipment purchases, space renovations, information systems, and relocation expenses. These reductions would be taken in order to continue support for: part of the January 1989 pay raise ($23.3 million), increased agency contributions for employee retirement benefits ($25 million), increased premiums for employee health insurance ($23 million), and partial funding of salary increases for employees in special occupations and/or geographical locations ($20.2 million).

--improve tax enforcement by (1) instituting an automated system to assess penalties on failure to make Federal tax deposits, thus fostering greater compliance with deposit regulations and improving the collection of revenue; (2) resolving more promptly tax disputes, in administrative appeals, thus accelerating the flow of revenue into the Federal treasury; (3) securing more tax returns, particularly "trust fund" returns, from business which did not file; and (4) expanding employment tax compliance programs with emphasis on determining proper classification of employees, thus identifying improper classification of independent contractors.

These four compliance efforts will cost $58.5 million in budget authority and will require an increase of 1,150 positions (full-time equivalency). They will produce additional tax revenues of $150 million in FY 1990 -- a return on investment of 2.6 to 1. Specifically, program yields and costs are as follows:

(Dollars in Millions)

Program	FTE	Budget/Authority	Additional Revenue	Yield to Cost
FTD penalties	74	$ 2.4	$ 7.7	3.3 to 1
Tax disputes (appeals)	216	$12.8	$ 39.2	3.1 to 1
Secure delinquent returns from businesses	597	$30.7	$ 86.2	2.8 to 1
Employment taxes	263	$12.7	$ 16.9	1.3 to 1
Total	1,150	$58.5	$150.0	2.6 to 1

2. How the IRS would allocate any additional FY 1989 funding over the current FY 1989 levels, along with yield-to-cost at each level, for the following levels: $10 million, $25 million, $50 million, $75 million, and $100 million.

Answer: The Internal Revenue Service has already reallocated funds to meet mandatory pay and benefit costs and has redirected funds to improve service to taxpayers during the filing season. A supplemental allowance of $100 million would be used to restore funds redirected from a variety of programs and expenditure categories in support of these objectives. There would be no revenue change from restorations of this magnitude.

Chairman PICKLE. Thank you, Mr. Murphy, and we are glad that you are with us here, again.

I am sure all of the members have many questions they want to ask because there are various phases of your testimony we want to ask further questions about. I am going to ask each member to comply with the 5-minute rule. We will come back, then, to additional questions as we proceed, and the Chair will try to abide by the 5-minute rule, initially.

Now, Mr. Murphy, you have indicated that you submitted your budget and you got an increase of several million dollars, up to $5.5 billion.

Is there any real increase in your budget for next year, considering the fact that you have had to absorb some $350 million worth of increased costs this year?

Mr. MURPHY. There is——

Chairman PICKLE. Is there a real increase?

Mr. MURPHY. There are real increases, Mr. Chairman, as I indicated, in the areas of Taxpayer Service, tax system modernization, and tax enforcement. We are absorbing, Mr. Chairman, some of those costs that were not reflected in that budget, and that is why, as I indicated, we are trying to deal with those additional costs in 1989.

Chairman PICKLE. Well, in some areas there may be increases; in others, decreases. But overall, it seems to me there is no real increase. When you take the $5.2 billion and you add to that the $350 million that you have had to absorb, you end up with about $50 million less for the total budget.

So I really question whether there is any increase. I think we have to start off on a basis that there is no real increase in your budget for this next year.

Now, I am going to try to break some of that down. I would ask you, is there any money specifically in this budget to carry out the Taxpayers' Bill of Rights?

Mr. MURPHY. No, there is not, Mr. Chairman. As I indicated, there is nothing in the budget to reflect the entire Technical and Miscellaneous Revenue Act, the Anti-Drug Abuse Act, and the Medicare Catastrophic Coverage Act.

Chairman PICKLE. Well, isn't that true also about the drug enforcement act?

Mr. MURPHY. That is correct, Mr. Chairman.

Chairman PICKLE. No money on that?

Mr. MURPHY. There is nothing in our budget on that. We are discussing the implementation costs with Treasury and look forward to working with OMB as well to resolve those differences.

Chairman PICKLE. All right. Now in your testimony you talked about the increased efficiency and accuracy rate of your telephone service, and as I understand it, you said your accuracy rate is now 27.8 percent.

Three weeks ago it was over 37 percent. The GAO said it was over 40 percent. Now within 3 weeks time your accuracy rate has gone from 37—using your own figures—down to 27. How do you explain the increased percentage in that short time?

Mr. MURPHY. Mr. Chairman, if I said that, I apologize. What I was referring to was the percent wrong. The 27.8 percent is the percent wrong, Mr. Chairman.

Chairman PICKLE. Wrong. That is what I meant, and I apologize.

Mr. MURPHY. And that is, as I indicated, a slight increase. I also indicated, that still does not fit into our acceptability range. But let me point out, Mr. Chairman, that in dealing with the complexity of the law, we are showing signs of improvement as a result of the second part of the new system, and that is to find out where the weaknesses are, get that out through the regional diagnostic centers and into the field, so immediate corrections can be made.

I am optimistic that we can improve on that, although I would certainly admit, Mr. Chairman, it has not shown a drastic increase.

Chairman PICKLE. Last session, you said that you were going to increase your telephone accuracy rate because of the increased assistance in the Automated Taxpayer Assistance Service Program, and you promised you were going to show that increase for this year. That has not been shown.

Now you have no increase of money for the Automated Taxpayer Assistance, is that not correct? You told us last year that that is where your money is going. I do not see any increase in money for the Automated Taxpayer Service System. Is there a need for that money, and, if so, why didn't OMB request it?

You did request that, Mr. Murphy, from the OMB, but you did not get any, and it is not in this budget.

Mr. MURPHY. There is an amount, Mr. Chairman, in our base for the Automated Taxpayer Service System, but the amount is $1.8 million. I believe that there was an additional amount asked for that was not approved, but we do have funds in there. As I testified in my last visit, Mr. Chairman, we do have that test system set up in Dallas, TX, with 40 automated work stations.

Chairman PICKLE. It just seems to me, Mr. Murphy, that you do not have any money in the Taxpayers Automated Service System and that is how you are going to improve your accuracy.

There is no money in the budget, so I do not see how you expect to have any real increase in accuracy, and yet, you do come in and show us about a 10-percent difference in 3 weeks time.

Now I want to touch on one other thing, quickly. You started off your testimony this morning saying that in the computerization system, over a 10-year period starting in 1990, you are going to have a new system, and you are going forward, or essentially, I think that was your statement.

Now, Mr. Murphy, we have been fighting this computerization problem here, now, for over 5 years with Internal Revenue Service. Five years ago we got in a horrendous mess in this country. We could not even process the returns we had; even manually.

We got them all bogged down. We had probably the most embarrassing situation Internal Revenue has ever had. We concentrated on it, and you finally corrected your front-end processors.

But your own former Commissioner said recently that you are still operating down the street in the Ice Age, as far as equipment is concerned.

We have been asking something be done. Now all we have done in 5 years is improve front-end processors, but they are old equip-

ment. They are out of date, they will be totally out of date, if we do not start until 1990, and over a period of 10 years. That means to me that the American taxpayers know that the Internal Revenue Service is going to be 10 years behind everybody else, maybe.

Now have you requested money in advance? Have you got a specific plan for us in the modernization of the computer system?

Mr. MURPHY. Mr. Chairman, we do have a specific management plan for tax system modernization. In the fiscal 1990 budget, there is an increase of $102 million in ADP, and $70 million of that has to do with the tax system modernization.

As I indicated, and as you so adequately point out, it is essential that our budget for 1990 be approved with that increase, so that we can assure that we can get out of the ice ages in our tax system.

I believe, Mr. Chairman, what we are asking for in 1990 will ensure that, but we need your support in obtaining those resources.

And Mr. Chairman, I really feel strongly that I should correct the record on the point you made before about the 37-percent error rate. What I said, Mr. Chairman, was there was a slight improvement in the error rate, but it did not go up 10 percent; it just went up a little over a percentage point. So it did not go up 10 percent, Mr. Chairman. Thank you.

Chairman PICKLE. Well, I am glad you set the record straight. That just means, though, the situation is worse than we had thought by your earlier statement. It is embarrassingly still at 30 percent, instead of 27 percent it is 36 percent then.

Well, Mr. Commissioner, I am going to conclude, and say to you that it is not adequate, in my judgment, just to request $100 million to start this computerization system.

I do not think this Republic of ours has got any more important problem ahead of us than adequately preparing in the computerization age. We have not done it. We have fought hard to just get the front-end processors, and unless you are bolder, we are going to be bogged down again, and embarrassed with our tax system, and this administration, or any administration, had better face the fact that we are going to have to cough up a lot of money and we had better do it quickly, and we cannot just assume business as usual in this computerization field.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Welcome, Mike Murphy, before the committee again. We are happy to have you and are pleased to have your testimony.

Mike, many feel that small taxpayers who receive notices from the Matching Program pay the notices rather than dispute their appropriateness.

Do you have any information which might indicate the percentage of people who pay amounts less than $500 versus those who pay more than $500 without disputing the claim?

There is a feeling that taxpayers who owe small amounts, rather than go through the hassle, sit down and send off a check, versus those who owe large amounts. I do not know whether there is any way to prove that, and perhaps you are not prepared with those figures today. But if you are not, perhaps you could send them to us, or give them to us for the record. I would appreciate having them as preliminary to looking into the situation more deeply.

Mr. MURPHY. Congressman Schulze, I would be glad to look into that. Let me also remind you that in our communications with taxpayers we have an objective of trying to clarify notices, and to make it very clear to taxpayers exactly what these notices mean, so that we can have clear understandings. But I will provide that information to you, sir.

[The following was subsequently received:]

The Service does not capture or maintain statistics on the percentage of taxpayers who pay without dispute in response to an IRS notice, regardless of amount. Even if such data were maintained, it would not necessarily be helpful to the Service in determining the taxpayer's reaction to the notice.

Mr. SCHULZE. I understand that, Mike, but there is a feeling, which I sense as I go around the country and talk to accountants. Even the accountants may even say it is the easy way out, because it is a small amount. Rather than go through the hassle and pay for the time for going through this, they say let's pay it and get it out of the way.

I hope that is not the case, and that is why I would like to have the figures. Let's just look at them and see if they tell us anything.

Mr. BRENNAN. We do not believe that is the case, Congressman, but we will provide you with the figures that also show——

Mr. SCHULZE. Great. Any backup material you have to prove that I would——

Mr. BRENNAN. A vast majority are for well over $500.

Mr. SCHULZE. The chairman was discussing your budget request, and I would like to take just a minute, Mike, and talk about it.

The budget request was $1.3 billion higher than the OMB approved, but you also said, if I was correct, that you are still discussing the budget situation with OMB.

Did I hear you correctly when you said that, and, if so, can you be a little more specific and tell me how those discussions are going, and whether we could relax until those discussions are ended?

Mr. MURPHY. Congressman Schulze, I mentioned that I look forward to working with the Treasury on any changes that would take place as a result of the new legislation.

As far as our dealings with OMB are concerned, as you well know, that process has many stops along the way. We have put forth our needs to Treasury, and Treasury has transmitted those to OMB. As I testified, I feel as though the 1990 budget does move tax administration forward, even though I acknowledge there are some unfunded areas that we will have to deal with.

Mr. SCHULZE. Mike, if you received the $1.3 billion and over 13,000 more employees—and I realize in the bureaucracy there are times when we put things in that are a little higher than they might, in order to give them the satisfaction of cutting a little—can you tell me, at this higher level of funding, what level of staffing you would be allowed to achieve? Or where would you put the additional staffing if you received the amount that you had requested?

Mr. MURPHY. Congressman Schulze, I am going to ask Mr. Wedick to respond to that question, if you do not mind. John.

Mr. WEDICK. Congressman, the differences between what we requested originally and what ultimately was allowed were in certain

revenue initiatives that we put forth which were not approved. Parts of these revenue initiatives were allowed and parts were not.

We had a more ambitious information system, or ADP, program than was ultimately allowed, although I want to make sure the record reflects that our request for resources for tax system modernization was allowed in its entirety.

The amount of money that we have for tax system modernization in our 1990 budget, an additional $80 million, was what we requested. It was approved in its entirety by Treasury, and it was approved in its entirety by OMB.

There were other differences in terms of what we would call unavoidable costs. For example, not all of the January 1989 pay raise was funded. Thirty-one million dollars was not, and that was in our original request. The total requirement was $113 million. All but $31 million was funded, so we ended up with most of the 1989 pay raise funded in our 1990 budget, which solves most of the problem we are faced with in this fiscal year.

Mr. SCHULZE. Would that also prevent you from going on with other programs, or expansion?

Mr. WEDICK. Well, to the extent that we have to find a way to fund that remaining $31 million, yes; but that is a lot better than having to fund $113 million. In addition, there were other absorptions of mandatory costs which we were requesting money for, and it was decided that we, along with all the other agencies, had to find ways to absorb those costs.

Mr. SCHULZE. Is this falling harder on taxpayer service or on enforcement? In other words, where would that money have gone? What I am leading up to, Mr. Wedick, so that you understand where I am going, is this. My next question is going to be how much additional revenue would this have brought in if Congress gave you the additional money?

So that is why I want to be fairly specific, to know where you would have put that money, and then what the result would have been.

So had your original request been provided, how would that have been divided between service versus enforcement?

Mr. WEDICK. I do not have the numbers right here. We can provide them to you.

Mr. SCHULZE. If you would.

[The following was subsequently received:]

Our original FY 1990 budget submission to the Department of Treasury provided 39 percent for service and 61 percent for enforcement.

The final budget submitted to the Congress for FY 1990 continues to place strong emphasis on service to the taxpayer while still maintaining a viable enforcement program. In FY 1990, 40 percent of our requested resources are for service to the taxpayers while 60 percent is for enforcement programs. This reflects an increase over FY 1984 when 30 percent of our budget was for service and 70 percent was for enforcement. The IRS has made a commitment to provide an 85 percent level of service to taxpayers through our toll-free answering system. In addition, resources are being made available to ensure timely processing of tax returns and the issuance of refunds.

Mr. WEDICK. But it would go generally across the board. Here, again, if you are faced with the absorption of moneys for a pay raise, then that falls on both sides of IRS, both on service and on enforcement.

Mr. SCHULZE. So it would not change the 60/40 enforcement-service ratio is what you are saying? It would be about the same?

Mr. WEDICK. Yes.

Mr. MURPHY. In fact, Congressman Schulze, I think you just hit on the key to it when you asked about taxpayer service as well as the enforcement side. We really do feel that in presenting the 1990 budget, we must maintain that balance. In answer to your question about service to the taxpayers, we feel that if that increase is supported by the subcommittee, and the budget is approved, then we can improve on the service to the taxpayers.

Mr. SCHULZE. Mike, my time has expired. Let me take my follow-up question very quickly, then. If that had been funded fully, how much additional revenue would it have brought in? Do you have that figure, or, if not, can you also provide that?

Mr. WEDICK. We will provide that to you.

[The following was subsequently received:]

Our original budget submission for FY 1990 proposed several revenue initiatives. An Examination revenue initiative would have produced $551 million in new revenues at a cost of $185.1 million. A Delinquent Returns initiative would have produced $272 million in revenue at a cost of $110.1 million. The original initiative for International Compliance proposed spending $7.5 million to generate $39 million in revenue. Final approval for this initiative was for $6 million which would generate $29 million.

Mr. SCHULZE. Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman. Mr. Murphy, thank you for being present and responding to our questions. Let me ask you about accounts receivable, if I might.

Can you tell me what is the current accounts receivable inventory down at the IRS.

Mr. BRENNAN. Yes, sir. At the end of January, it was $65 billion.

Mr. DORGAN. $65 billion?

Mr. BRENNAN. That is right, sir.

Mr. DORGAN. And how does that compare with the period of time—for example—the last several years on the same date?

Mr. BRENNAN. As of February 1988, for example, it was $53.5 billion.

Mr. DORGAN. OK.

Mr. BRENNAN. Let me just add a footnote to that. We know of two rather large cases which are duplicate assessments, and they are protective assessments. So there is $7.7 billion by which the $65 billion should be reduced.

Mr. DORGAN. You mean you have got a couple of cases that total $7 billion?

Mr. BRENNAN. Yes, sir.

Mr. DORGAN. Two cases?

Mr. BRENNAN. Two cases. They involve a lot of taxpayers.

Mr. DORGAN. Oh, I see.

Mr. BRENNAN. They are protective assessments.

Mr. DORGAN. I thought you were talking about Mr. Milken or someone of that ilk. Sixty-five. Fifty-three last year?

Mr. BRENNAN. Fifty-three billion last year. Fifty-seven billion this year would be, in my judgment, a comparable figure.

Mr. DORGAN. All right. How much of that is noncollectible, in your judgment?

Mr. BRENNAN. That is a figure that we are working on. We had a study by an outside firm that has helped us to go through the process. Actually, we need a new information system to come up with exact data, so we do not have an exact figure right now. I can supply for you what we normally call "currently uncollectible" figures.

Mr. DORGAN. All right.

[The following was subsequently received:]

As of March 31, 1989, the amount of accounts receivable considered "currently not collectible" was $14.2 billion.

Mr. DORGAN. Is the roughly $60 billion, the 65/53—$60 billion range—is that a range that concerns you? Does it bother some, or is that an acceptable range to the Service, given the amount of taxes they now collect?

Mr. BRENNAN. No, it is not acceptable. We would like to at least stop the increase.

Mr. DORGAN. What proposal did you make to OMB to increase the number of collectors?

Mr. BRENNAN. Maybe Mr. Wedick can help me out with the exact figures. I do not remember them right now, but we do have in our 1990 budget, as I recall, additional funds for dealing with the——

Mr. DORGAN. I understand that. What I was asking is what you requested. I understand what has been given you. Mr. Wedick.

Mr. WEDICK. I am not so sure I have all the detailed information. According to my information, the amount we requested for collecting delinquent accounts is in our budget right now. The amount we requested, in other words, made it through both the Treasury review and the OMB review.

We also had requested additional funds seeking to secure additional delinquent returns, and that was one of the items that was not approved.

Mr. DORGAN. Well, in fact, I was going to ask about that. In fact, OMB, I think, has told you that they are cutting by some 600 or 700—well, actually not quite that—but they are cutting the number of people you have for delinquent returns investigations, even as they increase slightly the number of people for collections.

Now does that concern you as administrators? When we talk about the tax gap of nearly $100 billion, delinquent return investigations—it seems to me that you would probably want to increase that activity, not decrease it.

Mr. MURPHY. We feel, Congressman Dorgan, that our 1990 request, which the administration has approved, will give us the opportunity to collect 21,000 additional delinquent accounts, and generate $107 million in additional revenue.

Obviously, the more you get the more you are going to be able to collect, but the amount we have requested is really what we are hopeful will be approved.

Mr. DORGAN. Giving me those numbers does not mean very much to me, because you tell me what you are going to collect with

that amount of resources. The question is, What would you collect if you had the resources necessary?

If I had a $60 billion accounts receivable out there, I would sure want to recommend to OMB the resources sufficient to deal with that, and if I had a $100 billion tax gap, I surely would not want to see delinquent returns investigation staff diminished, and that is what has happened.

My concern has been that the Internal Revenue Service has been polite all the way through the 1980's with OMB, and I do not think there is a need for you to be polite. I understand you are a part of the team and a part of the administration, and you would not serve your career interests by sitting at that table and telling us your candid observations about OMB and the administration throughout the 1980's, and what they have done to the IRS budget.

Nor am I someone who believes that we ought to just throw money at this problem. I think, however, with the nearly $60 billion accounts receivable, an audit rate that is diminishing—not increasing but diminishing—and the need for more examiners, with things like delinquent returns investigators being cut back in the budget—that concerns me, I do not think there is any great need for you to be polite about what someone else in the administration is doing to you in the budget cycle.

Mr. MURPHY. Congressman Dorgan, it does concern us, but when you talk about figures like $65 billion in accounts receivable, and $80-some billion in the tax gap, you also have to recognize that not all of that is collectible. I am sure you are aware of that.

All I am saying is that in maintaining the balance between service and enforcement, we think this 1990 budget does move us forward in tax administration. Frankly, Congressman Dorgan, right now—and I recognize what you are saying about our relationship with OMB and Treasury—I am concerned that we get approval of the increases that are in the 1990 budget. I hope you accept that.

Mr. DORGAN. I understand that. But the examination rate has been decreasing, not increasing, as you know, and our goal is not to have an examination rate decreasing, it is to have it increasing. At some point we have got to reconcile the downward trend of examination rates with the need for some investment in the Service to collect the money that is out there.

Let me, in the very short time I have remaining, ask one other question.

The task force that did an analysis of how to narrow the tax gap recommended something called enhanced taxpayer service functions. A program called IRS Across America, which would combine a whole series of functions that would focus on taxpayer service.

I intended, if I had the time, to ask questions about telephone service from States like North Dakota, that have seen their IRS employees migrate to Minneapolis-St. Paul and available to the folks on the telephone, and taxpayer assistance. This is something that has concerned me over the years.

I wanted to ask a bit about that. But more specifically, because I do not have time to ask about that, specifically I would like to ask——

Mr. CHANDLER. Mr. Chairman. Mr. Chairman. If you would like, I would yield my time to you.

Mr. DORGAN. Well, I will just finish up. I would like to ask the gentlemen whether you have considered a broader-range program of taxpayer service that many of us think would be scored as substantial increases in revenue, similar to the kind of program we had suggested in the tax gap task force? I do not see anything that suggests that in the documents that you have given us today.

Is there anything that you are working on that would enhance taxpayer service, and taxpayer assistance as opposed to the enforcement side? I support better enforcement but I also believe that better taxpayer assistance is the key to better compliance.

Can you describe for me what you are doing in that area.

Mr. MURPHY. Congressman Dorgan, we certainly agree with you on what you are saying about that. There are some studies going on—I believe I reported on that last time—in our Research area attempting to decide how you could go about scoring revenue that would come from providing service.

I do not have even an interim report on that right now, sir. I think the enhancement of Taxpayer Service is essential, whether it be through continuing with trying to improve on our accuracy problem, or through proving to ourselves, and to anybody who reviews us, that voluntary compliance and good customer service are equally essential to tax administration.

Mr. Wedick just put some figures in front of me, and I believe I covered them last time. In our budget request for 1990, we do have requests for improvements in training, better supervision, quality controls, and more time to deal with taxpayers. But I do not think that addresses your specific concern about how you figure out how much revenue is gained by taxpayer service, and I will just have to report back to you when I have more information on that.

Mr. DORGAN. Well, Mr. Chairman, I thank my colleague, the gentleman from Washington, for his generosity. If I might just make one final observation.

I would like, if you could submit to the committee, or subcommittee, an analysis of whether there is a long-term strategy in taxpayer assistance that represents a kind of a program of the type that we have discussed, that we think would be helpful.

[The following was subsequently received:]

Taxpayer Service has adopted a long-term strategy for providing taxpayer assistance. This strategy is embodied in the Taxpayer Service Division Annual Business Plan, which is communicated throughout the Division. The FY 1989 plan states that our "primary mission is to promote voluntary compliance by educating and assisting taxpayers in fulfilling their federal tax obligations. We strongly believe that *quality* customer service is the most effective means of accomplishing this mission." We went on to define "quality customer service" as providing assistance based on the principles of ART: Accuracy, Responsiveness, and Timeliness. The plan also stressed the need to instill the principles of quality throughout our planning processes. The purpose of the Annual Business Plan is to illustrate and strengthen the linkage between the Taxpayer Service Division's short-term goals in the major program areas and the Servicewide long-term goals outlined in the IRS Strategic Business Plan, which covers a five-year period.

The Annual Business Plan addresses the major program areas of quality assurance, resources, training, technology, telephones, walk-ins, written referrals/correspondence, the Problem Resolution Program, Taxpayer Education, and Taxpayer Information. For each program area, the plan describes the specific goal of the program as well as the standards and measurements to be used in evaluating the program's effectiveness. For the FY 1989 plan, Taxpayer Service pioneered the use of new methodology to develop quality standards and measures for the toll-free tele-

phone program. We are now beginning to develop new standards and measures using this methodology for the other program areas as well.

Mr. DORGAN. And also, I will ask OMB this question. I want to know whether OMB still believes that they score as a loss any substantial investment in taxpayer assistance. That has been our problem, and that has been your problem.

If you invest a dollar in enforcement they score it as a gainer; if you invest a dollar in taxpayer assistance they score it as a loser. Well, it is not a loser. Anybody who thinks very clearly understands that if you improve taxpayer assistance, that you are ultimately going to improve compliance.

And I will ask OMB that question when they appear. If you have observations about it, I would appreciate hearing them.

Mr. MURPHY. I will be glad to provide that, Congressman Dorgan.

[The following was subsequently received:]

IRS' Research Division, working with Price Waterhouse, conducted a study on The Effects of Taxpayer Service on Voluntary Compliance. The study report is still under development at Price Waterhouse, but is expected to be presented to the Service in final form in the next month or so.

Mr. MURPHY. Also, I would like to point out to you that based on a recent followup I made, taxpayers in North Dakota are getting access into that St. Paul call site. But I would caution everybody, that people should try to avoid the busy times in our toll-free telephone system, like Monday and Tuesday between 10 and 2. Calling earlier in the morning or later in the day, I think, would improve on the access that you have been concerned with.

Chairman PICKLE. Thank you, Mr. Dorgan. Now I would like to go back, Commissioner, and cover some of the other fundamental questions we did not get to complete earlier.

First, I want to comment on the concern I have about the so-called implementation of the fee for telephone service. I notice in your budget documents that the Internal Revenue had been discussing with the telephone company the feasibility of implementation of this fee.

Are you still conducting those discussions?

Mr. MURPHY. Mr. Chairman, the working group that was asked to look into this is still involved in the study process—dealing with providers, also getting advantages and disadvantages and really putting more emphasis on whether it would be feasible to even have this.

As I mentioned to you before, there has been no recommendation made to me; there has been no discussion of a policy decision on it; and I am well aware of the concerns of this subcommittee about the fact that we have problems with accuracy but at the same time, we are talking about charging people user fees. That is the best I can give you at this time.

Chairman PICKLE. Well, you are saying, Mr. Commissioner, that discussions are still ongoing, and that the administration is still considering the possibility of implementing a telephone service fee?

Mr. MURPHY. I am saying, Mr. Chairman, that discussions are ongoing.

Chairman PICKLE. And they are ongoing in spite of the fact that your accuracy rate now is 37 or 36 percent incorrect. And yet you are going to start charging a fee for incorrect information?

Mr. MURPHY. Mr. Chairman, I said that our percent wrong is 27.8 percent. I did not say it was 36 or 37 percent. But the analogy that you used between the problems we have there versus the issue of user fees is one that I am aware of.

We did obligate ourselves and commit to reviewing this. We never did say, Mr. Chairman, that we were proposing this be done.

Chairman PICKLE. What I guess we can both agree on, whether we like it or not, is that you are still looking into the possibility of charging a fee for telephone service.

Now, let me go to another subject. Last year in your budget you estimated that 64 million American taxpayers would be assisted in 1989. Now, this year, you estimate that there would only be about 55 million taxpayers who are going to be assisted. That is 12 million less than last year, 1988. Why would there be 12 million fewer people that you are going to assist?

Mr. MURPHY. Mr. Chairman, I testified that we would be assisting 68.4 million taxpayers of which 38.8 million would be in the telephone answering sites. I believe that the 38.8 million—and I do not have the figures handy here—is very, similar to what we are projecting for this year.

Chairman PICKLE. Well, in the budget we received, as I have it, you had said that you would be only able to assist 55 million taxpayers.

Mr. MURPHY. Mr. Wedick has got an answer on that, Mr. Chairman.

Chairman PICKLE. It would be 12 million less people, and I am simply-trying to say, if that is so, is that due to funding?

Mr. WEDICK. The 55 million taxpayers that we were projecting we would assist was based on the budget dollars before any redirection of funds into Taxpayer Service. We have, in fact, redirected funds into Taxpayer Service——

Chairman PICKLE. Mr. Wedick, what is your testimony today on the number of taxpayers you will be able to assist next year?

Mr. WEDICK. A very important feature of our 1990 budget is that it does provide 1,300 additional positions for Taxpayer Service, and that will enable us to assist a projected 68.4 million taxpayers.

Chairman PICKLE. Now——

Mr. WEDICK. In fiscal year 1990.

Mr. MURPHY. And Mr. Chairman, I might add——

Chairman PICKLE. That is only on the assumption that you get all of these other people, the extra personnel?

Mr. WEDICK. That is based on the assumption that Congress will, in fact, approve our 1990 budget as submitted by the administration and as supported by OMB. Yes, sir.

Chairman PICKLE. Well, I think we still have some difference in what we think are overall figures.

Mr. MURPHY. We would be happy to check the record on that, Mr. Chairman.

Chairman PICKLE. I will check that.

Now, let me talk to you about your audit rate. The Service has asked the Treasury for about 3,000 more positions in the examination account in 1990 than the administration requested in its budget, which is submitted to the Congress. What would have been

the audit rate under the IRS budget request? Do you know what that audit rate would have been?

Mr. BRENNAN. No, I would have to submit that for the record. I can give you the audit rate as projected for the budget before us—it is 1.23 percent.

Chairman PICKLE. That is under the administration's proposed IRS budget?

Mr. BRENNAN. Yes, sir.

Chairman PICKLE. What would have been the audit rate under the IRS's budget proposal?

Mr. BRENNAN. Under our original proposal? I would have to submit that for the record, sir.

Chairman PICKLE. Well, I understand you said, from your copy here that you submitted to us earlier, that it would be the same figure. Is that correct? You said it is 1.23?

Mr. BRENNAN. That is projected with this budget.

Chairman PICKLE. In the IRS budget request, you said you thought that the audit rate would be 1.23, and I am asking you what would be the audit rate under the administration budget request?

Mr. BRENNAN. I am sorry. I am answering it.

Chairman PICKLE. Even though you have less, 3,000 fewer people?

Mr. BRENNAN. Let me just back up and see if I can clarify that. Under the administration's budget right now, we project the audit rate for fiscal 1990 at 1.23 percent.

Chairman PICKLE. All right. It seems to me like it is the same thing in spite of the fact that you will probably get 3,000 less employees in that area. Now, how can that be?

Mr. BRENNAN. I do not know of any 3,000 less employees, sir.

Chairman PICKLE. Well, the administration budget has 3,000 fewer positions than IRS requested.

Mr. WEDICK. Mr. Chairman——

Chairman PICKLE. That is under the administration's budget, and yet you are saying to me that you get the same audit rate with 3,000 less people.

Mr. WEDICK. We do not have with us the audit rate that would have been produced if we had gotten the 3,000 additional positions. That would be, as one might suspect, somewhat higher than the 1.23 percent, which is the audit rate that will be produced if the Congress approves the budget that we have before it.

Chairman PICKLE. Well——

Mr. WEDICK. We will be glad to provide that——

Chairman PICKLE. Well, I hope you can. I just raised a question. How is it possible that the audit rate will be 1.23 percent when staffing would decrease from the 1989 level and the 1989 audit level is only 1.1 percent? It seems to me like that is inconsistent. But give us some information on that, and maybe we can straighten that out.

Mr. WEDICK. I think I might be able to help you in that regard.

[The following was subsequently received:]

Based on the Service's original budget request to the Department of the Treasury, the overall audit coverage rate for the income and estate and gift tax areas was estimated at 1.26 percent for FY 1990.

Chairman PICKLE. Well, overall, let me ask you. In the last 10 years, I am told that the audit rate has fallen from 2.1 percent in 1980 to the estimated level of 1.1 percent for 1989. Is that correct?

Mr. BRENNAN. Yes, sir.

Chairman PICKLE. All right. Now, what is going to be the impact of the decline in the audit rate on voluntary compliance? Your audit rate has gone from 2.1 percent down to 1.1 in 1989. Is that acceptable? Is that disturbing? Is that alarming?

Mr. BRENNAN. Acceptable, no. We always try to raise it up. Part of that is due to our initiatives of trying to audit the most complex returns with the resources that we have. So that is why part of the reason of the declining audit rate——

Chairman PICKLE. Mr. Brennan, I either cannot hear you, or——

Mr. BRENNAN. I am sorry.

Chairman PICKLE. You are searching for an answer.

Mr. BRENNAN. Part of the reason for the decline is that we audit the most complex returns with the resources that we have, and the returns that are being filed are more and more complex.

Mr. MURPHY. In other words, it takes longer, Mr. Chairman, to conduct those more complex examinations, and as a result of that, the rate of coverage would slip, and that has happened over the years.

But let me just throw in a commercial here, Mr. Chairman, for our budget for 1990. I just would like to remind you and other members that we are asking for $101 million for correspondence audits, which would examine another 183,000 tax returns and would result in an improvement of the coverage. I do not have the exact percentage of the improvement.

Chairman PICKLE. Well, let me just expand on one or two areas, and I will yield to some of these members.

Some of your cases are obviously more complex, and it does take more time. Let us ask a question now in the area of expert witness fee funding. The Internal Revenue has received only half the money necessary to pay expert witnesses to assist your chief counsels' office in large cases, that is in both 1989 and 1990.

Is it true that the Internal Revenue Service has run out of money to pay expert witnesses this year?

Mr. MURPHY. Mr. Chairman, there was a request for $8 million in expert witness fees that was reflected in the supplemental you referred to before.

I have asked the Office of Chief Counsel what the impact of that would be, and I am told that this would be negligible to Chief Counsel due to the drop in the projected number and the size of these expert witness contracts. Besides that, they have adopted a new procurement procedure on how they would obligate expert witnesses' costs. So we are not seeing a negative effect from that. I know in your opening remarks you said that we did not have money to pay those fees. I just do not have any specifics on that, as I indicated last time.

Chairman PICKLE. Well, I am advised that you have run out of money, that at least you are going to run out of money for expert witnesses by the end of this year, and I raise the question. If that is so, I ask the question, are you settling the big cases simply because you do not have the money to pursue them?

Mr. MURPHY. Mr. Chairman, that is not the case. I am not aware of any case that is being delayed because of the lack of expert witness fees.

Chairman PICKLE. All right.

Mr. MURPHY. If you have some specifics on that, I would be happy to look into it.

Chairman PICKLE. All right. Let me go to another step further than that. In the area of these large leveraged buyouts, we asked the Internal Revenue Service, and we asked the Treasury, Secretary Brady when he was before us last month, how many of these audits have been completed? He wrote me back a letter of a very general nature which said, in effect, that none had been completed in the last several years. At least, none of the major ones, transaction through complete audits, there may be seven or eight cases of a small nature.

Now, you are not completing any of the audits on these large LBO's by the Secretary's own admission. They are complex. They are not just in one city or one office. They are scattered all over the country, but none of them are being audited. You go after these little fellows, but you will not go after the big ones, the leveraged buyouts. You said that none of these cases are not being pursued because you are hurt by lack of funding. It seems to me like that is an absolute inaccurate statement.

Mr. MURPHY. Mr. Chairman, we are not saying that they are going without any type of examination. Our examination function has completed a preliminary analysis of the 63 LBO transactions valued at $50 million or more which took place in 1987. Of those 63 cases, Mr. Chairman, 39 were already included in what we refer to as our Coordinated, or large case, Examination Program.

These 63 LBO transactions had a dollar value of $33 billion, and $29 billion of it was included in the Coordinated Examination Program.

We will continue to study these LBO transactions, Mr. Chairman, but let me just share with you, very briefly, that we do not have an audit classification that says, "LBO." A lot of times what you have is in a specialized industry, or you have different study groups that look at some of the areas of noncompliance.

This is certainly one that we are, as I indicated, making analysis of. We are not just ignoring them. There are 74 tax returns with LBO transactions under examination today in the Coordinated Examination Program.

I would be happy to furnish additional information for the record on this, Mr. Chairman.

Chairman PICKLE. Well, Mr. Murphy, the figures you are giving me are information that we do not have. We do have from the Secretary that he has some 70 large corporations that are currently being audited, but they are just auditing with respect to one facet of that overall LBO transaction not a complete audit.

Now, if I am incorrect, I would want to be so informed. When you say that you're auditing 70, that does not mean that you have any intent of completing any auditing of these big transactions. If you have completed any of the audits of these big transactions, over the $10 to $15 billion category, in the last 5 years I would like

to know about them. I do not think there have been any. Have there been any?

Mr. MURPHY. Mr. Chairman, I do not have any specific information when you put it strictly in the category of LBO. LBO-related transactions, as you know, can go on whenever you have a merger or an acquisition, and they occur throughout the economy. I do not have specifics that would say we have completed an LBO-type audit, other than to testify to you that we have many, many LBO-related transactions under examination.

Chairman PICKLE. Well, Secretary Brady submitted information to the committee in answer to our specific question, and said that information on LBO transactions audited over the last 3 years is not available. He does not have it, or at least we do not have any information.

Now, you may have some ongoing audits, but I think you just do not have a complete one in any sense of the word. We need to know, have you audited them? Have you completed any audits? Will you be able to complete any within the next year or two or three? I think the American people are entitled to know that.

Mr. MURPHY. Mr. Chairman, as I said, if we have 74 of them that are under examination, I would certainly hope that we will complete some of those in the next couple of years. Otherwise, we will be back up here again.

I would be happy to provide you whatever additional information that I have for the record, Mr. Chairman. I expect that those examinations that I just reported on will be completed over the next few years, and I would be happy to give you a report on that then.

[The following was subsequently received:]

As you know, IRS examines tax returns, not LBOs as such. Since all parties to a transaction cannot be identified without an examination, and since these parties can be located in many IRS districts throughout the nation, the coordination required in the typical LBO can be substantial.

In January, Examination conducted a survey of its large cases were LBO transactions took place in a year under examination. As a result of this effort, three significant concerns were identified which need to be addressed:

1. Because reorganization and acquisition issues are not unique to LBOs are they, to any substantial degree, already included in the normal course of IRS examinations?

2. If a compliance problem is identified, what special coordinating procedures and auditing techniques would be required to handle the examination of these large, complex, and geographically dispersed entities?

3. How can all taxpayers involved in an LBO be identified during the IRS return classification process?

To address these problems, the IRS has taken two actions. The first action is the designation of leveraged buyouts as part of the IRS Industry Specialization Program. The LBO Industry Specialist will identify key cases that contain LBO issues and represent the leading edge in issue development. The Industry Specialist will also determine if compliance problems exist. The Industry Specialist convened an LBO Industry Specialization meeting in late April with representatives from the Examination Division and the Office of Chief Counsel who have knowledge and experience in LBO-type issues. They reviewed potential LBO tax issues to determine what coordination will be necessary and to discuss audit techniques which will assure uniform and effective quality examinations. They also explored ways of coordinating examinations that are geographically dispersed.

The second action is the assembly of a task force of field personnel this spring whose purpose will be the following:

1. To develop a system for coordinating LBO transactions between Coordinated Examination Program (CEP) cases and non-CEP cases;

2. To develop procedures for examinations of LBOs where the transactions involve geographically-dispersed taxpayers;

3. To determine Examination's training needs in the LBO area; and
4. To develop a system to measure costs and results of LBO examinations.

Chairman PICKLE. Well, I do not think we are going to settle this question. It is obvious to me that you are trying, but if these transactions are so big that you audit the individual taxpayer, then why do you not audit the transaction? At least none of them have been completed yet, in effect, and I think this is a serious weakness.

But let me yield to some of the members now and we will come back with some other questions.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Mike, I also had intended to ask you about the user fee for telephone calls. I presume from your answer that that is not imminent. Is that correct?

Mr. MURPHY. Congressman Schulze, I know that you are trying to pick up some time here. As far as what is imminent, all I can tell you is that we continue to do what we obliged ourselves to do. I do not want to use the word "explore," because I know what the chairman will say, but what I would say is we are testing the feasibility of that proposal, and we have not made any decision on it.

Mr. SCHULZE. Let me just urge strongly that you do not consider it until you improve the accuracy rate, because it would just be like lighting the fuse of a small bomb, with respect to public relations. It may be something downstream which you might want to consider, but I would improve the accuracy rate substantially before you even spend time considering it.

Mr. MURPHY. Let me assure you, Congressman Schulze, I will take what you are saying under very careful consideration.

Mr. SCHULZE. Last year, Mike, we were discussing the utilization of credit cards for individuals to pay their taxes. What has happened to that concept? Is it still under consideration? Were there major problems with it? Does it look good, or where does it stand?

Mr. MURPHY. Mr. Brennan will handle that one, Congressman.

Mr. BRENNAN. It does require legislation for us to do that. The legislation is still under active consideration. I am not sure of the exact status of it right now, but we can supply that.

[The following was subsequently received:]

A legislative proposal to amend the Internal Revenue Code to permit acceptance of tax payments through the use of a credit card was initially submitted by the Administration on September 13, 1988. No action was taken on this proposal during the 100th Congress.

An identical legislative proposal was submitted by IRS to the Treasury Department as part of the Service's 1989 legislative package. The proposal was approved by Treasury and forwarded to OMB in early April. We expect the proposal to be approved by OMB in the near future.

Mr. SCHULZE. I have wondered for some time whether it would not be a good idea to use, as a measure of your efficiency, the amount of interest you pay, because of failure to issue a refund check within the statutory period. Would that be too hard a standard? First of all, do you have the figures? How long now does it take for you to issue a refund check? How do we stand on the amount of interest to be paid this year versus last year, and is that a fair standard to judge your efficiency?

Mr. BRENNAN. Yes, sir. I'll provide the exact numbers for the record.

[The following was subsequently received:]

Between May 31, 1988 and October 1, 1988, IRS paid interest totalling $12.6 million. During the comparable period in 1987, the Service paid a total of $8.3 million. The reasons for the increase between 1987 and 1988 are discussed in the testimony.

Mr. BRENNAN. That is one of the standards that we use internally, to look at how much interest we pay out each and every year. And each and every year we try to reduce it. It did go up just a bit last year due to two things. One was the interest rate changes. If the interest rate goes up and down, that obviously affects our performance.

Secondly, last year, more returns were filed that looked like what we call "full paid," but which turned out to have errors in them. We found errors in the taxpayers' favor, so we corrected them and gave taxpayers more money back. So it did go up a bit.

Our forecast for it this year—very preliminary—is for it to go back down over last year.

Mr. SCHULZE. How long does it take now to issue the check once it is determined that a refund is due?

Mr. BRENNAN. We started out with 4 to 6 weeks in terms of paper returns. We are now getting into the 6 to 10 week period on paper returns. Electronic filing, obviously, is 17 days, no matter when you file.

Mr. SCHULZE. Mike, I wanted to ask you some questions. The GAO will testify with respect to the automated examination system, saying that it borders on being a disaster.

Well, now wait. They do not go that far, but they say it is a bleak picture. The GAO says the expanded system was to be completed by 1989 at a cost of $1 billion, but the cost estimates have risen by $800 million, and the schedule has slipped by 6 years and that the hardware and software were extremely cumbersome to use. They also say that 77 percent of the agents were dissatisfied with the software and only one-third used it, that the software is being rewritten, and that AES benefit estimates have been questionable—a fair amount of negative comments on this system. I want your response to the GAO analysis.

Mr. MURPHY. Congressman Schulze, I am going to ask John Wedick to respond to that. He wants to make just a brief followup to your last question before doing that, if you do not mind?

Mr. WEDICK. The brief followup, Congressman, concerns the use of the amount of interest that we pay as a measure of our effectiveness or efficiency. In my view, it has a volatility to it that makes it not terribly useful for that, because as Mr. Brennan outlined, two things happened last year.

If you look at the two things that happened, neither was under our control. One was an increase in the interest rate. The second involved taxpayers filing what appeared to be a return that owed money, but when we processed it we found the taxpayers were entitled to a refund. There, we had to pay interest. We did not know a refund would be due at the time the return was filed, so it was very difficult, if not impossible, for us to detect those situations.

Mr. SCHULZE. That category is increasing?

Mr. WEDICK. That category was fairly large last year. We think it was large because of the new Tax Reform Act. We will not know,

however, until this year when we start processing the full paid returns, which will be after June 2. June 2 is the date by which we plan to will have all of the refund returns processed.

Mr. SCHULZE. OK.

Mr. WEDICK. On the situation of AES. I have read the GAO testimony, and I do think it paints, perhaps, too bleak a picture. On the other hand, what is reflected in the GAO testimony on that system, in terms of the difficulty in quantifying its benefits, is correct. We have had some difficulty in attempting to quantify those benefits, and that, quite frankly, is the reason why AES was not supported at Treasury and was not supported at OMB for fiscal year 1990. That is why, instead of $100-plus million in the budget for AES, we have $19.5 million. I would agree with that, because we were not able to support the productivity increases.

On the other hand——

Mr. SCHULZE. Are you heading toward the elimination of the program?

Mr. WEDICK. No. No. What we are doing——

Mr. SCHULZE. Should it be eliminated?

Mr. WEDICK. Pardon?

Mr. SCHULZE. In other words, if it is not going to work, should we cut our losses and say, "If this baby is not going to work, let us get rid of it."

Mr. WEDICK. No, not at all. What we are doing is reassessing the whole approach that we are taking to the remaining phases. Right now, phase one is in place. That is, we have some 18,000 laptops in the hands of the examiners.

The GAO testimony does focus on the AES situation early on, when folks were having a lot of trouble with a tremendous number of floppy disks. Now, it is down from 18 to 7. We intend to proceed, as we are able to justify the budget increase, to what is referred to as a hard disk configuration, which means you get rid of those floppy disks.

We are going to restructure the AES initiative and make sure it is competitive in future budget submissions, whether it is 1991 or 1992, because it makes imminent sense. In Examination, people are using it. They are high-paid professionals, and they can be very effectively supported by information systems. It makes sense, and we are going to make sure that it happens.

In terms of integrating it into the whole tax system modernization effort, that was always in our plans, and that will happen. So we will correct the problems we had with it, and proceed with it in a bit of a different configuration.

Mr. SCHULZE. Keep us apprised of the progress in that area if you will.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman. Mr. Murphy, let me observe that I think you should have a LBO project. I really feel the Internal Revenue Service, given the level of mergers and acquisitions in this country—around $300 billion worth last year—some of them taxdriven. At least the ones I read about, in many cases, a linchpin represents the tax benefits that they are trading.

I think the Service ought to have a specific LBO enforcement mechanism of some type that it ought to organize. If you do not have one, let me just encourage you to consider administratively doing that.

Mr. MURPHY. Congressman Dorgan, I mentioned before that there were two IRS study groups already involved in it. One of them involves our LBO Industry Specialist, who is the newest addition to our Industry Specialization Program. What you are suggesting is exactly what we have in mind, so I appreciate your——

Mr. DORGAN. And I think Chairman Pickle is right on point. I think this is an area where you ought to be aggressive. My sense is that we sit around here in this country and have all of this activity going around us and the inaction costs us lost revenue.

For example, I have been interested in trying to figure out how some of the junk bonds that are issued have been categorized as debt rather than equity—a venture capital masquerading as debt, and I guess it is probably because Treasury says, "Here's the line," and if it is over this line, and therefore, you administer that way.

I think that you ought to aggressively enforce in these areas and give us recommendations on problems in these areas, so that we can legislate as well.

Mr. MURPHY. We will be working with the tax policy people at Treasury on that, Congressman Dorgan. At the same time, I am sure you recognize that geographic dispersion on these types of transactions is also one of the challenges that we have to get a little bit smarter in dealing with.

Mr. DORGAN. One of my concerns has been, throughout the 1980's, that at Justice and Treasury and virtually everywhere in the administration, they have been cheerleaders, rather than fence inspectors here.

Starting with Bill Baxter back in 1981, they thought all of this activity was wonderful. If you just end up with a few corporations in America, they thought it would make a stronger America.

When you do talk to policy makers over in Treasury or wherever you talk to them, see if you can find some who believe as I do, that we ought to be pretty watchful about some of these activities.

Let me get back to some of the information you submitted this morning. Two questions.

First, I went back after our first round of questions and got some information. You submitted to Treasury a request for 1,097 more positions for taxpayer service than OMB gave you in the budget submission. Now, if that is the fact, and that is the information I have, that you requested 1,097 more for taxpayer service. What services would have been provided under your submission that are not now going to be provided, because of OMB's budget restrictions? Can someone——

Mr. MURPHY. Congressman Dorgan, a lot of the things that we started last year and reported on then indicated the move toward additional training and toward keeping people on board longer during the filing season. Other areas were converting temporary employees to permanent and improving the accuracy area, which certainly needs more improvement. All this is reinforced in the 1990 submission in the request for 1,300 staff years.

But let me point out something else very important, and I think you hit on it. The $50-some million that is in there for improving Taxpayer Service is included for the purpose of having that clearly funded through the appropriations process. This saves us from the position where, in order to maintain that balance that you cited before, we have to be moving funds from one appropriation to the other.

So it accomplishes two things. I think it gives us more strength in improving our programs and delivering on them, and at the same time, it does make it very clear that it is important to have Taxpayer Service balanced by tax enforcement.

Mr. DORGAN. But my point is that OMB apparently still does not believe that. Is that the case?

Mr. MURPHY. I am not sure that that is. In specific numbers, it would certainly give you that impression, but I believe that Treasury and OMB were certainly aware of the fact that we had to have both taxpayer assistance and tax enforcement. So it was not as though anybody at OMB or Treasury said, "Hey, that is not an important program to the Service."

Mr. DORGAN. But repetitive behavior should allow you to draw some observations or conclusions from it, should it not?

Mr. MURPHY. I am going to put all of my stock, Congressman Dorgan, on the fact that I would like to see the increases for 1990 supported. That to me is the telling tale on this one.

Mr. DORGAN. I understand, and the laboratory repetitive behavior tells you something, and it seems to me the same is true with OMB's evaluation of budgets with respect to taxpayer assistance and taxpayer service. It seems to me that routinely in these past years, OMB has said the taxpayer assistance and the taxpayer service does not account for anything, because it costs us money and yields nothing to the Treasury. It appears to me that they still take that same approach, but I will ask them that when they testify.

Let me ask you to put on the record, if you would for us, your estimate of the cost in the positions that are required to fill the new responsibilities in the Omnibus Anti-Drug Abuse Act, the Technical and Miscellaneous Revenue Act, and the Medicare Catastrophic Protection Act. Those are three areas you testified earlier that that is not in the budget, and Mr. Schulze, I think, asked some questions about that and was trying to find out where it was up there hanging.

If you would tell us how much we are talking about—how much money we are talking about and positions we are talking about for those three? We would appreciate that.

Mr. MURPHY. Congressman Dorgan, we have recently submitted our estimates to the Department of the Treasury. We await the necessary reviews and the approval of those estimates.

In terms of a figure—and again I don't want to be playing games with you on it—that we feel will cover the three areas of legislation, it's in the neighborhood of a $100 million price tag.

Mr. DORGAN. Can I understand again why are they not included in the OMB budget, just a timing problem?

Mr. MURPHY. It is absolutely timing. And I did testify to both the House and Senate Appropriations Subcommittees that those fig-

ures were not in there, Congressman Dorgan, strictly due to timing.

Mr. DORGAN. My understanding was that on the Drug Abuse Act, the estimates you provided were around 504 positions for $56 million; the Miscellaneous Revenue Act, 522 positions, $45.3 million; and Catastrophic, 132 positions for $4 million.

Just for purposes of the record, would that be generally your understanding?

Mr. MURPHY. You are certainly in the ballpark, Congressman Dorgan. And we will provide for the record the figures once they are approved. All right?

Mr. DORGAN. Let the record show that I cited the figures and you said I was in the ballpark.

Mr. MURPHY. OK.

[The following was subsequently received:]

The IRS estimates are currently being reviewed by Treasury, and will then be forwarded to OMB for approval. These new tax laws will require the IRS to implement new programs or to expand existing ones. None of the recent laws authorized additional resources for the IRS.

In addition, the recent budget proposals made by President Bush include tax law changes (child care, energy, research and experimentation, capital gains, etc.). If these are enacted, they will impact on IRS operations and resources.

Mr. DORGAN. Thank you very much, Mr. Murphy. Again, let me say that my interest is in encouraging the Service to not only better enforce the law, and certainly we have an obligation if we have a revenue system to enforce it as best we can, understanding, as Chairman Pickle suggested, that we need to be mindful of the taxpayers' rights certainly, and prevent abuses. But I'm also concerned about taxpayer assistance, and would hope once again to encourage the Service to more formally develop some kind of a National Taxpayer Assistance Program that is identifiable and workable, and one that we can convince at some point OMB to support.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Dorgan.

Now, Commissioner, I know you've been here for sometime, and we have some other witnesses. But I want to ask you two or three other questions quickly.

In the area of exempt organizations, I understand that the administration denied your request, the IRS request for $2.4 million in additional funding for exempt organizations.

What effect will that have on either your enforcement or your service in this area? Does this constitute a problem for you?

Mr. MURPHY. Mr. Chairman, I really don't have the specifics on that. Let me ask my colleagues here if they do. If not, I would be happy to submit that for the record.

Chairman PICKLE. Well, my concern is that we are asking for additional enforcement and compliance measures in areas like TV ministers, the UBIT on unrelated business income tax area, and political and lobbying activities. All of those are problems that are growing and growing. Yet, you requested money to handle these problems, to enforce them, and the money is knocked out.

Now, does that constitute a serious problem for you?

Mr. BRENNAN. In those three areas that you mentioned, sir, we don't see our efforts diminishing at all.

Chairman PICKLE. Do you have a problem in the area of drug enforcement? You said earlier that you did not have any money that had been budgeted for you to carry on the work that's been given to you in this field.

Mr. MURPHY. Mr. Chairman, there is money in our base which permits us to continue in our work with the Organized Crime and Drug Enforcement Task Force.

There is also, as you indicated, a lack of funds appropriated for the Anti-Drug Abuse Act. It is very difficult for us to maintain a balance between the general enforcement program and the special enforcement program. Again, though, our submission to Treasury on this, we are hopeful, will help us resolve any problems that we have.

Chairman PICKLE. Well, there's not just inadequate funding. There's just no money for your drug enforcement effort in your budget, other than what you pull your base funding.

Mr. MURPHY. That's right.

Chairman PICKLE. And this creates a difficult problem.

Now, you're supposed to be going out all over the United States and checking on these various drug violations that might be occurring. You are working with the Justice Department, and you sign over a lot of your people to the Justice Department. I don't know how many, but a great many of them.

But you're having some drug problems in your own Service Center in Austin, TX. Last month, we had four or five people who were investigated, resigned from the Internal Revenue Service District Office, and perhaps will go to trial.

Now, is that happening in the other service centers?

Mr. MURPHY. Two points, Mr. Chairman.

First, on the amount of drug enforcement funds in our budget. There is $70 million altogether in the budget. Of that total, $56 million is in our Criminal Investigation Program and $14 million will be transferred to the Department of Justice for the Organized Crime Drug Enforcement Task Forces.

Second, on your point about the drug situation involving our employees. As you point out, we do have an ongoing investigation in Austin. We also have investigations going on in other parts of the country. In a large organization of 120,000 people, I'm sure you can understand how our employees oftentimes match the society that they serve. The internal security part of our inspection organization is very actively pursuing this issue, and where we have any integrity problems, they are being investigated, Mr. Chairman.

Chairman PICKLE. Last part of my question.

Do you know of any difficulty in the drug area at any other service centers in the country? Are you advised of any problems?

Mr. MURPHY. I'm aware that we do have other investigations, not only in service centers but in other parts of our organization. I believe the number of investigations is somewhere above 50, Mr. Chairman. I would be happy to present to you additional information on that if you would like.

Chairman PICKLE. We would like to have that.

Mr. MURPHY. Yes, sir.

[The following was subsequently received:]

Servicewide, the Internal Security Division of Inspection has 71 investigations currently underway relating to drug violations.

IRS is scheduled to implement its Drug-Free Workplace Program in the fall of this year. The program includes random drug testing for a number of sensitive positions, including a group of key executives and criminal investigators working on special assignments. The program also calls for applicant testing for law enforcement positions, testing based on "reasonable suspicion", voluntary testing, testing following an accident or unsafe practice, and testing as a follow-up to counseling or rehabilitation for illegal drug use.

The Service will also be utilizing its comprehensive Employee Assistance Program to emphasize drug awareness education, management training, counseling, referrals for rehabilitation, and coordination with available community resources.

Chairman PICKLE. Another question I want to ask you is with respect to the Combined Annual Wage Reporting.

Has the Internal Revenue Service reached an agreement with the Social Security Administration to accept cases for reconciliation for years prior to the tax year 1987 where a penalty assessment would be appropriated?

Mr. MURPHY. Yes, sir.

Chairman PICKLE. Have you reached an agreement with SSA?

Mr. MURPHY. Mr. Brennan will cover that, Mr. Chairman.

Chairman PICKLE. Mr. Brennan.

Mr. BRENNAN. We have an agreement with SSA that we signed in July of last year. It covers, I think, 1987 and forward. Social Security agreed, as part of that agreement, to work off the workload that they had.

Chairman PICKLE. Well, Mr. Brennan, does the Internal Revenue Service have the resources and the necessary programs in place to process these cases for tax year 1985 prior to the statute of limitations running out in February of 1990?

Mr. BRENNAN. No. Part of our agreement with Social Security was for them to work off their backload. We did not take over any new cases from them. We agreed to start as we did, and we're starting——

Chairman PICKLE. Well, as I understand, these cases are going to be off the books and there's no way to reconcile them if you don't act between now and February 1990 because the statute of limitations is going to run.

I'm asking you do the IRS and the SSA have a plan? Do you have resources in place to actively pursue these cases between now and the time that they expire? Do you know?

Mr. BRENNAN. Let me submit for the record the agreement and the actual years that we're working on, sir.

Chairman PICKLE. Well, we need that, and you should give that to us immediately because time is running out on this, of course. So, do that.

[The following was subsequently received:]

IRS and SSA have reached an agreement on these cases. On a case-by-case basis, IRS will be working large dollar amount tax year 1985 and 1986 non-revenue cases that are returned by SSA. On these cases, SSA will already have made at least two attempts to contact the employer by mail and an attempt to reach them by phone. IRS is developing procedures for working these cases. Based on conversations with SSA staff, we do not expect the volume of these cases will be large. IRS is committed to providing the resources necessary to work these cases.

Since employers are only required to retain employment tax records for four years, it is possible that tax year 1985 cases could prove to be a problem because of the timing: tax year 1985 records need only be kept until February, 1990. For this

reason, we will try to move quickly on these cases as soon as they are received from SSA. Also, there is some question as to IRS' ability to penalize employers for failure to file Forms W-2 for years in which the three-year statute of limitations has run. The Internal Revenue Code provisions dealing with the three-year statute of limitations on collection and assessment are unclear in this area.

While the official IRS-SSA Memorandum of Understanding (MOU) has not been formally amended to include these cases, both agencies have agreed verbally on the tax years involved and the type of cases to be worked. This item was included, however, in the yearly review of the Combined Annual Wage Reporting (CAWR) program that is required under the MOU and has been submitted to the Commissioners of both agencies.

Mr. BRENNAN. We have entered into an agreement with them, and both Social Security and IRS are following the agreement. I just don't have in my head right now the exact years that we're talking about.

Mr. MURPHY. Mr. Chairman, I'm told that where there is overcrediting involved, as long as we have the information, that that can occur without regard to the statute of limitations. But I would like to verify that.

Chairman PICKLE. I want you to give me that verification because I do not have that understanding, and I want to know.

Mr. MURPHY. OK. I will be happy to send that to you.

[The following was subsequently received:]

In these types of cases, overcrediting is generally involved, meaning that employers had reported larger dollar amounts to IRS on Forms 941, 942, etc., than were reported to SSA on Forms W-2 and W-3. As a practical matter, most of these cases that will be resolved will result in a correction to SSA records without a refund of tax issue arising. This occurs because a large percentage of the cases that are settled are resolved by the receipt of additional Forms W-2 or by the identification of mismatches in Employer Identification Numbers (EIN), thereby correcting SSA employee records. However, by law the Service is prevented from issuing refunds on cases in which the statute has expired. Such would be the case for any claims for refund by employers for tax year 1985 returns, since the statute expired on April 15, 1989.

Chairman PICKLE. Now, this is a question here.

On data processing and the tax system redesign, the largest cut in the budget that the IRS requested came in the area of computer services. I think the administration's budget submission was $357 million less for computer services than what the IRS had requested.

It seemed to me like the cut raised questions about what effect that would have on your workloads and what effect that would have on implementing, with some concrete plan, your computer services for the future? Regarding the $357 million less which was requested, will that affect your workloads?

Mr. MURPHY. Mr. Chairman, let me respond to the first part.

As I indicated before, in our tax system modernization plan, we do have sufficient funds in the budget so that, if it is approved, we can move along as planned on tax system modernization.

As far as the specifics on computer services, I am going to ask Mr. Wedick to comment further on that.

Chairman PICKLE. Mr. Wedick.

Mr. WEDICK. The part of our request that was not approved will not have an adverse impact on current operations. When I say current operations, I'm talking about operations in fiscal 1990.

It included a number of ambitious initiatives that were separate and apart from, but supportive of tax system modernization.

Once again, our request for money for tax system modernization was approved by both Treasury and OMB as we requested it. The reductions were in other areas. For example, one area that the reduction was in, we talked about previously, and that was AES, the Automated Examination System. The original request was for a little over $100 million, and the ultimate allowance was $19.5 million, which is critical to maintain the existing equipment. It was that kind of a reduction.

Chairman PICKLE. Let me conclude on this by saying we're not privileged to know exactly where you're going to cut and where you're going to add. But we do know that the total was reduced by a certain amount.

I think, personally, that the biggest problem you have at the Internal Revenue Service, in getting ready for the years ahead, is putting in place an adequate data processing computerized system.

If, as Mr. Gibbs, your outgoing Commissioner, said, you're actually operating down in the ice ages now, that's an embarrassment to this country. And, there is a great danger of damage to our volunteer tax system.

It seems to me that each year, each administration kind of puts off to next year spending this sizable amount of money to put this computer system in place. We've been looking at it and we've been studying it, and we're going to make plans. Each year, it looks like it's put off another 2, 3, 5 years.

Now, those years are rolling by, and the danger is out before us. And, unless we adequately address that problem, this or any other administration faces the fact that without modernized equipment, this whole system can come crashing down. I think that's the No. 1 problem ahead of you. This temptation to roll it over to next year because you don't have the budget won't be sufficient in the years to come. A lot more has got to be done, and it's got to be speeded up. The American people have got to understand that.

Mr. MURPHY. We agree with you, Mr. Chairman.

Chairman PICKLE. And the system must modernize.

So, I would hope that the next time we have any kind of a hearing that we have some concrete money in the budget, specific funds, which will be adequate. If we don't, we're going to get in big trouble in this country.

Mr. WEDICK. Well, the reason this year that we're asking for only $80 million is that this is basically a startup year. The subsequent years, as you would suggest, the years 1991, 1992, 1993 are going to be years in which we will need substantial resources to bring the modernization effort in. And we will request those substantial resources.

Chairman PICKLE. All right. Mr. Murphy, this completes my questions, unless any other member has got any questions.

We will submit to you several questions that we have not been able to touch on this morning. We will ask you to respond to those with answers in writing just as quick as you can so that we can be prepared for the budget process as it moves forward.

[The following was subsequently received:]

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April 26, 1989

The Honorable Michael J. Murphy
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Acting Commissioner Murphy:

I want to thank you for testifying at the Subcommittee on Oversight's hearing on the Administration's fiscal year 1990 budget proposals relating to the Internal Revenue Service. To complete our hearing record, I would appreciate receiving your responses to the following 6 questions, which are astericked, by the close of business, April 28, 1989, and all other questions should be answered by May 22, 1989.

SECTION I: OVERVIEW

1. The IRS sent a budget request to the Department of Treasury for 128,422 staff positions and $6.8 billion. The budget the Administration submitted to the Congress requests 13,312 less positions and $1.3 billion less in funding.

   (a) Why did the IRS think it needed 13,312 more positions and $1.3 billion more in funding?

   (b) What activities will IRS not do under the Administration's budget which it would have done under the budget it submitted to Treasury?

2. IRS testified that certain revenue initiatives were included in the IRS FY 1990 budget request to Treasury which were not included in the President's budget submission.

   (a) How much total revenue could have been brought in under IRS's proposal that will not be brought in under the Administration's proposal?

   (b) Please provide a breakdown of IRS revenue initiatives, by program, which were included in the IRS budget proposal forwarded to the Department of

Treasury, including cost, gross revenue, net revenue, cost to yield ratio, and a brief narrative describing the proposal.

*3. The April 14, 1989, bipartisan budget agreement calls for $500 million in additional net revenue in FY 1990 from IRS compliance measures. The President's FY 1990 budget submission includes a revenue initiative which, at a cost of $54.9 million, would result in $263 million in net revenue. Please provide the level of additional funding which would be necessary in order for IRS compliance measures to net the additional $237 million specified in the budget agreement. Further, please describe the revenue initiatives that IRS would implement with this funding and the cost, gross revenue, net revenue and cost-to-yield ratio of each initiative. Will the examination coverage rate increase in FY 1990 under any of these initiatives? If so, which ones and what will be the examination rate? Will the Administration be proposing an increase in the FY 1990 budget proposal for the IRS to reflect the costs associated with the increase in net compliance revenue of $237 million?

4. Has the IRS needed to reprogram or redirect resources since submission of the FY 1990 budget? Does this create or indicate a problem for next year that the Administration's FY 1990 budget request does not address?

RE: FY 1989 SUPPLEMENTAL REQUEST

5. IRS's budget submission to Treasury indicated a need for a supplemental appropriation this year, FY 1989, of 2,116 positions and $170 million. The Administration denied the request. What is the impact of no supplemental appropriation on the following:

   (a) Taxpayer Service? (IRS had requested $55 million)

   (b) Returns Processing? (IRS had requested $47 million)

   (c) Appeals and Tax Litigation? (IRS had requested $29 million)

*6. The IRS has assumed new responsibilities in FY 1989 and FY 1990 under recently enacted legislation.

   (a) What does the IRS estimate are the costs and positions required to fulfill these new responsibilities in FY 1989 and 1990:

--Omnibus Anti-Drug Abuse Act
--Technical and Miscellaneous Revenue Act (the Taxpayer Bill of Rights)
--Medicare Catastrophic Protection Act

(b) Will the Administration be proposing an increase in the FY 1989 appropriation or the FY 1990 budget submission in order to fund IRS's new responsibilities?

7. The General Accounting Office testified that funding shortages in FY 1989 resulted in the deferment of equipment replacements, cancellation of plans to convert some temporary positions to permanent positions, and curtailment of some compliance efforts. Would IRS provide details on the each of the areas reported by GAO and evaluate the impact?

SECTION II: EXAMINATION AND APPEALS

A. EXAMINATION

1. Looking at the trend in IRS's examination policy over the past few years, there has been a steady decline in the percentage of returns audited.

(a) Why is the IRS not auditing as many returns as projected in the budget submissions? Are there too few resources in Examination, or is this the first place resources are taken from to solve problems in other areas?

(b) Under the Administration's budget submission there will be a decline in examination staffing in FY 1990. How will IRS achieve an audit rate of 1.23% with fewer positions than those in 1989, when the audit rate is only 1.10%?

(c) Would the audit rate achieved in FY 1990 have been 1.23%, as indicated in the IRS budget request to Treasury, if the Administration had increased staffing by 2,837 positions as IRS requested?

2. IRS indicated last year that the audit coverage is much greater in the more difficult high income classes. What is the audit rate for individual taxpayers with income:

(a) Below $20,000?

(b) Between $30,000-$50,000?

(c) In excess of $100,000?

3. What is the audit rate in the corporate area for:

(a) Small businesses only?

(b) Medium size businesses only?

(c) Large businesses only?

How do these audit rates translate into actual numbers of firms examined? What are the most common issues under exam in each category?

RE: FY 1989

4. The Subcommittee has heard reports that examination cases are being settled more quickly because there are not enough employees to handle the current work.

(a) Is this true?

(b) How many employees have been redirected or furloughed out of Examination during FY 1989? How does this compare with last year's staffing level?

5. Have any examination programs been reduced or eliminated due to funding shortages?

6. How many cases pulled for examination are not examined because the IRS failed to act before the expiration of the statute of limitations? How does the IRS ensure Examination staff are working these cases (which expire April 15th) and are not redirected toward returns processing for the April crunch?

7. According to prior testimony of Treasury Secretary Nicholas Brady, the IRS is reviewing ways to improve its audit procedures with respect to LBO transactions.

(a) What efforts is the IRS making to expand the examination of leveraged buyout transactions?

(b) What resources, in terms of dollars and personnel, would be required to effectively review leveraged buyout transactions?

B. APPEALS AND TAX LITIGATION

1. The estimated inventories of Appeals and Tax Litigation continues to climb in FY 1990. Yet, the Administration requested a decrease of 5 percent in the number of positions.

   (a) Why are the case inventories increasing?

   (b) What can be done to reduce year-end inventories?

   (c) How much would these have improved under IRS's budget request for 1,268 additional positions?

2. What will be the impact on IRS's ability to retain qualified attorneys and other tax professionals if, as projected, the Tax Litigation receipts increase by 7,000 and there is a decrease in the staff level? What is the difference between the starting salary for law school graduates hired by the Chief Counsel's office and the salary offered by the private sector? How does the IRS compete?

3. Is there an increase in the IRS FY 1990 budget which will increase the caseload in the Department of Justice's Tax Division? Is there any coordination between the IRS/Treasury and the Department of Justice on this matter during submission of budget requests? Does IRS think that there should be?

C. EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS

1. The number of employee plan determination letters in FY 1990 is expected to double over the FY 1989 level. What will be the impact of the Administration's proposal, which decreases staffing, on IRS's ability to handle the increased employee plan workload?

RE: FY 1989

2. The IRS FY 1989 budget estimated 359,000 employee plan determination letters would be issued; yet that number is now much lower. IRS expects to issue only 100,000 determination letters in 1989. What accounts for this decrease?

3. Why is the FY 1989 audit rate for exempt organizations now estimated at 2.50% rather than the 4.67% rate noted in the FY 1989 budget? How does the audit rate for exempt organizations breakdown by type of exempt organization and by issues under examination?

SECTION III: INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

A. INVESTIGATION

1. The IRS indicated there would be emphasis on the General Enforcement Program (GEP) which investigates offshore banking and tax havens. Since GEP tax fraud

investigations initiated *are not* increasing in 1990, where is the increased emphasis being placed?

2. From 1983-1987, the IRS was second only to the Drug Enforcement Agency in investigations initiated in the Organized Crime Drug Enforcement Task Forces and now the Congress has enacted the Omnibus Drug Initiative Act.

   (a) How many agents are currently committed to the drug task forces?

   (b) How many additional agents will be committed to this effort in FY 1990? Is this increase solely due to new responsibilities assumed under the Omnibus Drug Initiative Act?

3. How many special agents will be committed to money laundering investigations? Is this an increase or a decrease over FY 1989 agents?

B. COLLECTION

1. The FY 1990 budget request for Collection totals 20,804 positions, an increase of 510 positions above the current FY 1989 level. Most of these new positions will be in accounts receivable. Yet, dollars collected from accounts receivable will increase by only $1.3 billion over FY 1989.

   (a) What will the accounts receivable inventory be at the end of FY 1990 if the Administration's budget request is approved?

   (b) Price Waterhouse recently completed its study of IRS's accounts receivable inventory. What did they determine were the reasons for the growth in accounts receivable?

   (c) How much money was lost in FY 1988 due to the expiration of the statute of limitations on collection? How does this compare with FY 1987? How many delinquent accounts does this represent?

(d) How many of the cases in accounts receivable are awaiting the outcome of a bankruptcy proceeding?

2. In the past, the IRS has suggested that we allow taxpayers to use credit cards to pay their tax liabilities.

(a) IRS testified that a legislative proposal for payment of taxes by credit card is still under active consideration. Does the IRS anticipate forwarding a proposal to the Congress in the near future? If so, when?

(b) If necessary legislation were adopted, how long would it take to implement this program?

(c) Does the IRS still estimate the cost to the federal government associated with credit card payments at $4.3 million?

C. TAXPAYER SERVICE

*1. At our hearing in March, the accuracy rate for telephone inquiries was 62% correct according to the IRS.

(a) What proposal or funding is included this budget to improve telephone accuracy which was not included in the FY 1989 budget?

(b) Under the Administration's proposal, how many taxpayer service employees will be converted from temporary to permanent and upgraded from Taxpayer Service Representatives to Taxpayer Service Specialists? What are the costs per conversion and per upgrade?

(c) How many additional conversions and upgrades would have been possible if the Administration had granted IRS's budget proposal to Treasury?

(d) What is the current attrition rate for temporary employees and Taxpayer Service Representatives? What are the costs associated with hiring and training to replace these employees?

*2. Did the IRS receive all of the resources requested for taxpayer service training? If not, by how much does the Administration's budget request fall short of IRS's request and what aspects of the training program will not be accomplished?

*3. IRS requested over $50 million for the automated taxpayer service system. The Administration approved only $2 million. IRS testified at the Subcommittee's filing season hearing that this system would be one way to improve the accuracy of IRS's responses.

(a) What will not be done under the Administration's request which IRS had planned to do with the automated taxpayer service system in FY 1990?

(b) How much of the $54 million, which IRS requested in additional funding for the automated taxpayer service system, could be used to advance the current system in FY 1990? Are there reasons to delay IRS's plans for the automated taxpayer service system unrelated to the availability of funding?

(c) How soon will this system be available to all telephone assistants?

4. What resources are necessary to raise the telephone accuracy level to 90%?

RE: FY 1989

5. IRS's budget submission indicated a need in FY 1989, this year, for $54 million to improve taxpayer service. The Administration did not approve the supplemental request.

(a) Does IRS have the resources this year to fully fund taxpayer service?

(b) If so, where did those resources come from?

(c) What could the IRS have done with the $54 million in supplemental resources requested?

6. We have received reports that the IRS will be closing the taxpayer assistance office in Yonkers, New York.

(a) How many taxpayers were assisted at this office in the 1988 filing season and 1989 filing season?

(b) Is this closure due to funding shortages?

(c) Will any other offices be closed this year? If so, how many taxpayers will be affected?

(d) Will any offices need to be closed under the FY 1990 budget proposal? If so, how many taxpayers will be affected?

SECTION IV: RETURNS PROCESSING AND COMPUTERS

1. Although the Administration's budget request increases the number of positions in Returns Processing and Computer Services, IRS had requested an increase which was three times that which the Administration submitted.

(a) Why did the IRS request 3,007 more employees for FY 1990 than authorized for FY 1989?

(b) What is the impact of the Administration's failure to approve IRS's request?

A. RETURNS PROCESSING

1. IRS projects 5 million additional returns will be filed next year. How will the 900 new positions accommodate those additional returns when 1,800 new positions were needed in the 1988 filing season to process a little over 4 million additional returns?

*2. GAO reported to this Subcommittee last year that there are serious problems with the quality of IRS's handling of taxpayer correspondence.

(a) What resources did IRS request to improve the quality of correspondence at the Service Centers?

(b) How much of this request did the Administration approve?

(c) What could the IRS have done to improve correspondence with the additional funding IRS requested and the Administration did not approve?

3. There are serious questions about the training and retention of returns processing personnel.

(a) Does the budget proposal provide the resources to improve the quality of returns processing?

(b) If not, how is the IRS improving the training of personnel to ensure fewer errors?

4. What is the IRS policy for handling and monitoring the status of bankruptcy Unpostables at the service centers? How much of the total Unpostables inventory is represented by accounts in bankruptcy?

5. Has the IRS reached an agreement with the Social Security Administration (SSA) to modify the July 12, 1988, Memorandum of Understanding Combined Annual Wage Reporting such that, on a case-by-case basis, SSA will identify large volume FY 1985 and FY 1986 non-tax cases and provide them to the IRS for penalty consideration?

   (a) If so, how many of these cases does the IRS expect to receive from SSA?

   (b) If SSA refers the cases to the IRS on or before November 1, 1989, does the IRS have the resources and necessary programs in place to process the FY 1985 cases prior to the running of the applicable statute of limitations?

B. COMPUTER OPERATIONS

1. When will the IRS reach a decision on the basic "system architecture" for a new computer system?

2. For the past two years the GAO has testified that the IRS data processing systems will begin to encounter capacity problems and be unable to fully process the necessary workload beginning sometime between 1992 and 1994. How long will it take the IRS to acquire and make operational the computer systems called for under the tax system modernization program?

3. How much will it cost to design and acquire the new computer systems called for under the IRS's Tax System Modernization program?

4. In FY 1989 Tax System Modernization appropriation was $80 million. In FY 1990 it had risen to $234 million. How much of this increase represents increased expenditures and how much of it is the result of reclassifying pre-existing computer projects as part of Tax System Modernization?

5. In terms of cost, what are the ten largest IRS computer modernization projects, and which of them are included in Tax System Modernization?

What determines which projects are included in Tax System Modernization?

6. The current budget documents do not provide sufficient detail to allow the Subcommittee to track the progress the Service is making in its efforts to modernize its computer operations. Please provide to the Subcommittee an accounting of the individual modernization initiatives and acquisitions currently underway, including their expected completion dates and projected annual costs.

7. For several years GAO has found that noncompetitive pay and limited training opportunities are hindering Federal efforts to recruit and retain computer personnel.

   (a) How serious is this problem for the IRS?

   (b) Has the lack of ability to recruit and retain computer personnel contributed to the delays in IRS computer modernization initiatives, such as the Service Center Replacement System, the Communications Replacement System, and the Automated Examination System?

   (c) What steps has the Service taken to improve its ability to compete with the private sector in retaining key computer specialists, and what additional steps should be considered?

SECTION V: EXECUTIVE DIRECTION AND MANAGEMENT SERVICES

1. Both IRS and Treasury had requested more than 600 positions for Executive Direction and Management Services than the Administration proposed in the FY 1990 budget. Where were those positions needed?

2. What is the FY 1990 funding level for the Statistics of Income (SOI) Division in the Administration's budget submission? What funding level did the IRS request from Treasury? How would SOI's activities and the timeliness of responses have differed in FY 1990 under the IRS's budget request? How does the Administration's FY 1990 budget request compare with the FY 1988 and FY 1989 funding level for SOI? What SOI activities involving

data collection and analysis have been reduced or eliminated in recent years due to a lack of resources?

3. The Subcommittee's hearings on the filing season revealed that the availability of forms is a problem again this year. Management Services is responsible for the printing and distribution of tax forms.

   (a) Are the continuing form availability problems due to the reduction in staffing in this account?

   (b) How will a decrease in positions in FY 1990 affect the National Office's oversight of form availability?

4. The budget proposal for FY 1990 will reduce Management Services staffing to half the level it was in 1988. How could such a reduction occur without affecting some IRS functions and how will this reduction affect overall IRS operations?

Finally, the Subcommittee is still awaiting the requested appendixes to your April 4, 1989, testimony. It may be necessary to forward additional questions for the record based upon the information provided in the appendixes. As always, I appreciate your prompt attention to this request.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/sal

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

SENIOR DEPUTY COMMISSIONER

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Ways and Means
Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515-6350

Dear Mr. Chairman:

This is in response to your request for additional information to complete the hearing record on the Subcommittee on Oversight's hearing on the Administration's fiscal year 1990 budget proposals relating to the Internal Revenue Service. I am transmitting answers to the fourteen questions you had marked as being of high priority (Section I, numbers 3 and 6(a-b); Section III, numbers C.1(a-d), C.2 and C.3(a-c); and Section IV, number A.2(a-c)). The remaining answers are in the process of review, and should be forwarded soon.

I apologize for the lengthy delay, but, as you know, a large part of the preparation time involves the necessary clearance with Treasury and OMB of IRS communications with Congress on fiscal matters.

If you have any questions about our responses, you may call Gayle Morin, Legislative Liaison, at 566-4071.

Sincerely,

Michael J. Murphy

Enclosure

cc: Hon. Richard T. Schulze

Bipartisan Budget Agreement

I.3. The April 14, 1989, bipartisan budget agreement calls for $500 million in additional net revenue in FY 1990 from IRS compliance measures. The President's FY 1990 budget submission includes a revenue initiative which, at a cost of $54.9 million, would result in $263 million in net revenue. Please provide the level of additional funding which would be necessary in order for IRS compliance measures to net the additional $237 million specified in the budget agreement. Further, please describe the revenue initiatives that IRS would implement with this funding and the cost, gross revenue, net revenue and cost-to-yield ratio of each initiative. Will the examination coverage rate increase in FY 1990 under any of these initiatives? If so, which ones and what will be the examination rate? Will the Administration be proposing an increase in the FY 1990 budget proposal for the IRS to reflect the costs associated with the increase in net compliance revenue of $237 million?

The bipartisan budget agreement does indeed call for $500 million in additional revenue from improved tax compliance. Unlike the last agreement, the revenue target is before cost (i.e., gross) not after cost (i.e., net).

To achieve a $0.5 billion gain in revenue, IRS will need to receive, at a bare minimum, a $113.4 million increase in budget authority over FY 1989. This will provide the cost of the two sets of revenue initiatives -- $54.9 million proposed in the President's Budget plus another $58.5 million to achieve the enforcement revenue target in the Bipartisan Budget Agreement. It is also important to recognize the need for $59.6 million to support mandatory cost increases, as offset by proposed reductions. If not provided, IRS would be required to absorb these costs. The potential for negative revenue impacts under this scenario is currently under review. As the minimum level of support, the $113.4 million increase would exclude all non-revenue generating program initiatives, with the following impact:

- Likely reductions in Taxpayer Service Program level of 10 million to 12 million calls;
- Inability to process 175,000 discrepant cases provided for in the memorandum of understanding with SSA on Combined Annual Wage Reporting;
- No further improvement in the accurancy of service center taxpayer correspondence;

- o A 3,700 case backlog of pending rulings on non-profit organization annuity plans;
- o Continued risk of a growing number of bribery and narcotics incidents within IRS; and
- o Virtual inactivity on Tax System Redesign, with substantial risk to processing capacity within the 1992 to 1994 time frame.

The additional $58.5 million would be allocated as follows:

	Budget Authority	(millions) Revenue Gain	Yield to Cost
- Collection: securing delinquent returns from businesses	$30.6	$ 86	2.8 to 1
- Collection: special compliance efforts on employment taxes	$12.7	$ 17	1.3 to 1
- Automate FTD penalties	$ 2.4	$ 8	3.3 to 1
- Counsel: resolve appeals in dispute	$12.8	$ 39	3.1 to 1
TOTAL	$58.5	$150	2.6 to 1

The additional revenue produced should be $150 million. When this is added to the $318 million revenue gain already proposed in the President's budget, FY 1990 additional revenue totals $468 million, which, when rounded, equates to the $0.5 billion figure called for in the bipartisan budget agreement. At this time, there are no increases being proposed which would effect the number of tax examinations performed or the examination coverage rate.

FY 1989 Supplemental Request

I.6. The IRS has assumed new responsibilities in FY 1989 and FY 1990 under recently enacted legislation.

a. What does the IRS estimate are the costs and positions required to fulfill these new responsibilities in FY 1989 and FY 1990:

-- Omnibus Anti-Drug Abuse Act,
-- Technical and Miscellaneous Revenue Act (the Taxpayer Bill of Rights),
-- Medicare Catastrophic Protection Act.

b. Will the Administration be proposing an increase in the FY 1989 appropriation or the FY 1990 budget submission in order to fund IRS's new responsibilities?

At this time it is expected that the requirements in FY 1989 for recently enacted legislation will be minimal and the IRS will be absorbing these costs from within existing appropriated resources.

Requirements for the new legislation are currently under review by the Administration. A determination will be made about the need for reallocations and/or funding increases to fulfill the requirements of the new legislation.

C. TAXPAYER SERVICE

III.C.1. At our hearing in March, the accuracy rate for telephone was 62% correct according to the IRS.

(a) What proposal or funding is included in this budget to improve telephone accuracy which was not included in the FY 1989 budget?

(b) Under the Adminstration's proposal, how many taxpayer service employees will be converted from temporary to permanent and upgraded from Taxpayer Service Representatives to Taxpayer Service Specialists? What are the costs per conversion and per upgrade?

(c) How many additional conversions and upgrades would have been possible if the Administration had granted IRS's budget proposal to Treasury?

(d) What is the current attrition rate for temporary employees and Taxpayer Service Representatives? What are the costs associated with the hiring and training to replace these employees?

(a) The budget proposal before you now contains $55.9 and 1,300 FTE to improve telephone accuracy which was not included in the FY 1989 budget.

(b) Under the Administration's proposal approximately 350 temporary taxpayer service employees will be converted to permanent status at a cost of $ 2.34 million ($ 6,685 per conversion). The Administration's proposal would also upgrade approximately 420 employees from Taxpayer Service Representatives to Taxpayer Service Specialists at a cost of $ 2.64 million ($ 6,285 per upgrade).

(c) Our initial request to Treasury would have allowed us to convert a total of 700 temporary taxpayer service employees to permanent status, a difference of 350 employees from the Administration's proposal. Similarly, our initial request to Treasury proposed the upgrading of a total of 1,000 Taxpayer Service Representatives to Taxpayer Service Specialists, a difference of 580 from the Administration's proposal.

(d) The current attrition rate for temporary taxpayer service employees is 38% and for Taxpayer Service Representatives the attrition rate is 35%. The costs associated with hiring and training to replace these employess is approximately $ 9 thousand per new hire.

III.C.2. Did the IRS receive all of the resources requested for taxpayer service training? If not, by how much does the Administration's budget request fall short of IRS's request and what aspects of the training program will not be accomplished?

The IRS did not receive all of the resources requested for taxpayer service training contained in our request to Treasury. The Adminstration's budget request is about $ 26 million short of IRS's request to Treasury. Of this $ 26 million, approximately $ 6 million would have been utilized to fund taxpayer service training.

Several aspects of the taxpayer service training program that had to be curtailed or postponed including facets of the training program dealing with (1) additional quality training for managers (2) supplemental training for both new hires and experienced employees dealing with changes to the tax law (3) ongoing training in the area of effective telephone techinques procedures (4) new employees will be scheduled for only Phase I training with Phases II and III provided as funds become available (5) updating of mid-level management training program (6) workshops for managers of visually impaired (7) updating of training courses to reflect changes to the tax law and current IRS procedures.

Automated Taxpayer Service

III.C.3. IRS requested over $50 million for the automated taxpayer service system. The Administration approved only $2 million. IRS testified at the Subcommittee's filing season hearing that this system would be one way to improve the accuracy of IRS's responses.

(a) What will not be done under the Administration's request which IRS had planned to do with the automated taxpayer service system in FY 1990?

(b) How much of the $54 million, which IRS requested in additional funding for the automated taxpayer service system, could be used to advance the current system in FY 1990? Are there reasons to delay IRS's plans for the automated taxpayer service system unrelated to the availability of funding?

(c) How soon will this system be available to all telephone assistants?

The Service had planned on beginning nationwide implementation in FY 90, however, we have changed our approach to stretch out the implementation, allowing for more thorough testing in the earliest stages. Rather than an accelerated, two year implementation plan we went to a prototype the first year, pilot at the same site the next year, 6 additional sites the following year, half of the remaining sites after that and the balance of the toll free sites in the final year. This plan is contingent on the success of the proof of concept phase during the prototype and pilot operations.

Although it is not practical to advance the current system without proving the first stages, site preparation and furniture modification/enhancement costs should be considered prior to the implementation. We estimate these costs to be approximately $18 million. A non-budgetary reason for delaying our original plans are based on a recommendation by MITRE Corporation in their independent evaluation of our system. This recommendation indicated that the system should not be accelerated. Thus allowing time to activate a Proof of Concept approach, proving current applications and cost benefit analyses, in a prototype site followed by a pilot operation for one year. The pilot to be followed by national deployment.

The current plan calls for installing the system in six additional sites in FY 1991, after the full-site pilot in Dallas; adding half of the remaining toll free sites in FY 1992 and the balance in FY 1993.

Returns Processing

IV.A.2. GAO reported to this Subcommittee last year that there are serious problems with the quality of IRS's handling of taxpayer correspondence.

(a) What resources did IRS request to improve the quality of correspondence at the Service Centers?

(b) How much of this request did the Administration approve?

(c) What could the IRS have done to improve correspondence with the additional funding IRS requested and the Administration did not approve?

The IRS requested $7.9 million and 202 average positions to improve the quality of correspondence in the Service Centers.

The Administration approved $2.1 million and 52 average positions of this request.

The primary purpose for the additional resources, $5.8 million and 150 average positions, was to decrease the span of control in the Adjustment Units in the service centers. This reduced span of control would have enabled management to become more proactive in the review of the technician's work to ensure a quality product. Although some of our planned improvements may be delayed due to the denial of additional funding, many of the planned actions are being funded from existing resources.

SENIOR DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman
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1105 Longworth House Office Building
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Dear Mr. Chairman:

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If you have any questions about our responses, you may call Gayle Morin, Legislative Liaison, at 566-4071.

Sincerely,

Michael J. Murphy

Enclosure

cc: Hon. Richard T. Schulze

Section I: OVERVIEW

1. The IRS sent a budget request to the Department of Treasury for 128,422 staff positions and $6.8 billion. The budget the Administration submitted to the Congress requests 13,312 less positions and $1.3 billion less in funding.

(a) Why did the IRS think it needed 13,312 more positions and $1.3 billion more in funding?

(b) What activities will IRS not do under the Administration's budget which it would have done under the budget it submitted to Treasury?

(a) The Service submitted a FY 1990 Departmental budget for an increase of 14,611 FTE and $1.5 billion. These additional resources were designed to maintain the Service at its present operating level, provide program increases to improve information systems, generate additional revenue, improve tax administration and to enhance service to taxpayers.

(b) The Administration approved 90 percent of the staffing requested and 81 percent of the funds requested by IRS for 1990. Increases for some programs that could not be fully met included:

- The scale-back and/or delay in certain ADP and systems modernization projects
- Partial funding of the examination revenue initiative
- Absorption of the January 1989 pay increase
- Partial absorption of various mandatory cost increases (with-in grades, advancement of trainees)
- New delinquent returns initiative to expand IRS detection of non-filing
- New initiative to accelerate resolution of tax disputes in appeals

FY 1990 IRS REVENUE INITIATIVES

2. The IRS testified that certain revenue initiatives were included in the IRS FY 1990 budget request to Treasury which were not included in the President's budget submission.

(a) How much total revenue could have been brought in under IRS' proposal that will not be brought in under the Administration's proposal?

The IRS proposed to Treasury various revenue initiatives for FY 1990. Of these, one was an Examination District Office initiative similar to the Examination initiatives approved for FY 1987 and FY 1988. The Examination revenue estimating process has been under review recently by both the General Accounting Office and the IRS. Data on which revenue flow rates were based has been found to be outdated and unreliable. The IRS is reviewing other methods of estimating Examination revenue flows and expects to have a new methodology in place by the end of this fiscal year. At present we cannot estimate reliably the revenue flows from an Examination District Office initiative. If we were to use our previous methods which were used to estimate the FY 1990 initiatives at the time, then the FY 1990 revenue initiatives would be expected to produce $902 million in FY 1990.

The President's budget request contains a different group of revenue initiatives which do not include an Examination District Office initiative. These initiatives are expected to produce $318 million in FY 1990.

(b) Please provide a breakdown of IRS revenue initiatives, by program, which were included in the IRS budget proposal forwarded to the Department of the Treasury, including cost, gross revenue, net revenue, cost to yield ratio, and a brief narrative describing the proposal.

(See attached sheets)

INTERNAL REVENUE SERVICE

FY 1990 Revenue Initiatives
(Dollars in Millions)

Initiative:	FTE	Cost	Gross Revenue Collected in FY 1990	Net Revenue Collected in FY 1990	Gross Yield to Cost Ratio
Examination District Office Initiative	3,254	$185.1	$551	$365.9	3.0 to 1
Accounts Receivable Collection Initiative	197	9.7	40	30.3	4.1 to 1
Delinquent Returns & Special Compliance Collection Initiative	2,193	110.1	272	161.9	2.5 to 1
International Compliance Initiative	110	7.5	39	31.5	5.2 to 1
TOTAL, Revenue Initiatives	5,754	$312.4	$902	$589.6	2.9 to 1

IRS FY 1990 Revenue Initiatives as Proposed to Treasury

IRS proposed new revenue initiatives in FY 1990 which would have brought in an additional $902 million in revenue at a cost of $312.4 million, a rate of return of 2.9 to 1.

o Examination

The Examination Revenue Enhancement Initiative would have increased the examination of tax returns by adding 3,254 FTE in FY 1990 including support and follow through staffing. An additional 44,000 tax returns would have been examined in FY 1990, generating an additional $551 million in revenue collected in that year. Over the life of the initiative, revenue assessments would have totaled $4.6 billion.

o Delinquent Returns

Collection planned to expand its Special Compliance Program, Returns Compliance Program, and Business Master File Taxpayer Delinquency Investigations Program under this initiative. We anticipated closing 110,000 taxpayer delinquency investigations and 29,000 other Collection cases in the first year of this initiative, resulting in an additional $272 million in tax receipts.

o International

With an additional $7.5 million and 110 FTE, IRS would have expanded its compliance presence abroad, examining additional individual and large-case corporate tax returns, addressing the problem of non-filing by U.S. citizens living abroad, and resolving additional competent authority cases, cases where a taxpayer is being taxed by both the United States and the country in which he is residing. To reflect the increase in activity by American taxpayers and corporations in South Korea, we also proposed to open a new foreign post there, resources for which are contained within this initiative.

Increased international activity would have resulted in an additional $39 million in revenue in FY 1990.

o Accounts Receivable

IRS requested an additional $9.7 million and 197 FTE to increase the number of Taxpayer Delinquent Accounts disposed. An additional 22,000 Taxpayer Delinquent Accounts would have been closed, reducing the accounts receivable inventory to $17.4 billion, collecting $40 million in FY 1990.

4. Has the IRS needed to reprogram or redirect resources since submission of the FY 1990 budget? Does this create or indicate a problem that the Administration's FY 1990 budget request does not address?

The IRS is considering some reallocation of existing resources in FY 1990. Discussions are now underway with the Department of Treasury and the Office of Management and Budget. The scope and magnitude of any reallocation must, of course, await Congressional action on the FY 1990 budget. We will provide specific information once decisions are reached in late summer or early fall.

5. IRS's budget submission to Treasury indicated a need for a supplemental appropriation this year, 1989, of 2,116 positions and $170 million. The Administration denied the request. What is the impact of no supplemental appropriation on the folowing:

(a) Taxpayer Service? (IRS had requested $55 million)

(b) Returns Processing? (IRS had requested $47 million)

(c) Appeals and Tax Litigation? (IRS had requested $29 million)

In all three cases not receiving the supplemental funding requested has caused the IRS to reduce non-essential services. These include cut backs in travel, training, office furniture and equipment, service contracts and telecommunications expenditures. We are also deferring office relocations and renovations and delaying the filling of vacancies. We gave top priority to our taxpayer service and returns processing operations, especially during the filing season. Besides our primary function of timely processing tax returns, we maintained an 85% call in rate in Taxpayer Service.

FY 1989 SUPPLEMENTAL REQUEST

7. The General Accounting Office testified that funding shortages in FY 1989 resulted in the deferment of equipment replacements, cancellation of plans to convert some temporary positions to permanent positions, and curtailment of some compliance efforts. Would IRS provide details on each of the areas reported by GAO and evaluate the impact?

We have had to address a funding shortfall of $360 million in FY 1989, but have not postponed or reduced any activity that would negatively impact our ability to collect taxes, issue refunds, or assist the taxpayer. This shortfall arose due to new costs that had to be absorbed, including the January 1989 pay raise, a higher government contribution to employee health plans, and the postage rate increase that went into effect last spring. Unbudgeted program requirements for taxpayer service, tax forms distribution, improved correspondence with taxpayers, lower than expected attrition, and greater work complexity have had to be addressed. In addition, we are making use of geographic area special salary rates to improve retention of employees, the cost of which must be absorbed.

Regarding the specifics of the GAO report, we furloughed temporary employees at certain service centers because of efficiencies of operations as well as lower than expected attrition rates. There were no personnel cutbacks to any program that dealt with processing tax returns. Certain, non-mandatory programs are being curtailed now, but they do not affect the processing of returns.

The deferment of equipment purchases is part of a plan the Service enacted to help reduce our deficit. We instituted a 4.76% across the board resource reduction in addition to cutbacks in our Information Systems and support expenditures.

Some compliance efforts have been affected, but the revenue impact is minimal.

SECTION II: EXAMINATION AND APPEALS

A. EXAMINATION

1. Looking at the trend in IRS's examination policy over the past few years, there has been a steady decline in the percentage of returns audited.

a) Why is the IRS not auditing as many returns as projected in the budget submissions? Are there too few resources in Examination, or is this the first place resources are taken from to solve problems in other areas?

The number of examinations during the last few years have not increased as rapidly as initially anticipated for several reasons:

- o Filed returns continue to grow more complex requiring greater time to examine. Generally, our coverage is much greater in these more difficult higher income classes.
- o Our commitment to quality in all our operations means we are taking the time to do things right.
- o Our current staffing mix emphasizes revenue agents who audit relatively few returns but produce high yield.

We base our projections on historical data. We expect to adjust these projections as we gain further experience regarding the impact of the Tax Reform Act of 1986 on examinations.

IRS has not redirected a significant number of Examination staffing resources to other functions during FY 1989.

b) Under the Administration's budget submission there will be a decline in examination staffing in FY 1990. How will IRS achieve an audit rate of 1.23 percent with fewer positions than those in 1989, when the audit rate is only 1.10 percent?

Although we have not as yet determined our best revised estimate for these two years, in general we expect FY 1990 coverage to be higher than FY 1989 even though staff is somewhat reduced. The reason is that as we complete the training of recently hired agents, more time is available for all personnel both trainees and agents used as trainers to examine returns. We will be shortly revising our estimate of exam coverage for FY 1989 and FY 1990 as part of the FY 1991 budget cycle.

c) Would the audit rate achieved in FY 1990 have been 1.23 percent, as indicated in the IRS budget request to Treasury, if the Administration had increased staffing by 2,837 positions as IRS requested?

In our original request to the Department, we estimated the audit coverage for the entire Income, Estate and Gift Examination program would be 1.26 percent in FY 1990. This estimate assumed an increase in coverage of .03 percent for the first year of a staffing increase. Our estimate in the President's Budget for FY 1990 is 1.23 percent, without a staffing increase.

2. IRS indicated last year that the audit coverage is much greater in the more difficult high income classes. What is the audit rate for individual taxpayers with income:

a) Below $20,000?

b) Between $30,000 - $50,000?

c) In excess of $100,000?

IRS collects data in income categories slightly different than those requested by the subcommittee. We are attaching a table which displays the individual examination coverage rates for 1988:

Individual Examination Coverage Rates, 1988

Income Level	% Coverage	# of returns
< $25,000	0.65%	64,066,000
$25,000 - $49,999 (1)	1.28%	27,550,000
>$50,000 (2)	2.53%	11,635,000

Notes:

1) Includes returns with Schedule C or Schedule F attached with total gross receipts (TGR) between $25,000 and $99,999.

2) Includes returns with Schedule C or Schedule F attached with TGR $100,000 and over.

3. What is the audit rate in the corporate area for:

a) Small businesses only?

b) Medium size businesses only?

c) Large businesses only?

We are defining "small business" as those corporations with assets of less than $10 million, "medium size business" as those corporations with assets between $10 and $100 million and "large business" as those corporations with assets over $100 million. IRS also examines the tax returns of foreign corporations which owe U.S. tax (filed on Form 1120F), and 1120S corporations (small business corporations). We are attaching a table which displays corporate examination coverage rates for 1988:

Corporate Examination Coverage Rates, 1988

Asset Class	% Coverage	# of returns
< $10 million	0.92%	2,806,000
$10 - $100 million	18.76%	36,300
>$100 million	53.54%	9,200
Form 1120F	2.54%	17,000
Form 1120S	0.99%	892,000

How do these audits translate into actual numbers of firms examined? What are the most common issues under exam in each category?

Examination collects the data on the number of tax returns examined, and not on the number of "firms" examined. We also do not have any statistical data on tracking specific issues by class of tax return.

4. The Subcommittee has heard that examination cases are being settled more quickly because there are not enough employees to handle the current work.

a) Is this true?

IRS data does not indicate that cases are being settled more quickly.

b) How many employees have been redirected or furloughed out of Examination during FY 1989? How does this compare with last year's staffing level?

IRS estimates that Examination will realize very closely all of the budgeted technical staffing levels in FY 1989. The overall budgeted staffing levels as shown in the FY 1990 President's Budget showed a decline of 858 positions from the FY 1988 actual staffing level (34,097) to the FY 1989 authorized level (33,239). There have been no significant redirections of Examination staffing resources to other functions during FY 1989. IRS has not rected any nationwide furlough of any Examination employees. Locally, some furloughs may have occurred but the numbers of persons affected would be very small.

5. Have any examination programs been reduced or eliminated due to funding shortages?

We have not reduced or eliminated specific Examination programs as a result of funding shortages, with the exception of a part of the document matching program.

The document matching program, which involves both Examination personnel and the Returns Processing function, has been reduced in terms of discrepancy cases to be resolved for tax year 1987 tax returns.

6. How many cases pulled for examination are not examined because the IRS failed to act before the expiration of the statute of limitations? How does the IRS ensure Examination staff are working these cases (which expire April 15) and are not redirected toward returns processing for the April crunch?

We assume that by the term "cases pulled" that you are referring to tax returns that are placed in inventory for potential examination. The IRS does not maintain national statistics on examinations which fail to be brought to completion because of statute expiration.

We have established guidelines for the timely initiation of examinations of all returns. These procedures state that the examination and disposition of income tax returns will be completed within 26 months (individual tax returns) and 27 months (corporate tax returns) after the due date of the return or the date filed, whichever is later. These guidelines are well within the statutes of limitation time frames.

Any tax return that is currently open under examination with an imminent statute date is given top priority by Examination personnel in all Examination offices, District and Service Center. Sufficient resources are directed toward completing the examination of these returns on a local basis or to secure the taxpayer's agreement to an extension of the statute.

No Examination staffing resources have been redirected in the service centers during FY 1989 to the Returns Processing function to assist in processing tax returns.

7. According to prior testimony of Treasury Secretary Nicholas Brady, the IRS is reviewing ways to improve its audit procedures with respect to LBO transactions?

a) What efforts is the IRS making to expand the examination of leveraged buyout transactions.

The IRS has taken two initiatives to get a handle on the examination of leveraged buyout (LBO) transactions. The first action was taken in November of 1988. The Examination Division designated LBOs as part of the Industry Specialization Program (ISP). The Industry Specialization Program in IRS is an Examination program designed to identify and develop issues common to an industry, and to insure the consistent and uniform treatment of those issues nationwide. It establishes a focal point, the industry specialist, for providing examiners with specific technical and audit expertise.

Several issues prevalent in most LBOs have been identified. Chief Counsel is working with the Examination Division to assess the technical and litigating merit of these issues. Those issues determined to have merit by both Examination and Chief Counsel will be coordinated nationwide.

The Industry Specialist is also currently identifying key cases that contain the LBO type issues. These cases will represent the leading edge of issue development. A meeting of the case managers and team coordinators of several of these cases was held the week of April 24, 1989. Representatives of both Examination and Chief Counsel discussed various issues and factual situations related to LBOs. These live case situations will be used for the application of the law to the facts. Technical briefs are currently being prepared for approval and subsequent use by field examiners. In this way the law can be administered in a uniform manner. These briefs will be made available to the public.

Independent from the LBO phenomenon, but related to it, is a new Industry Specialization Study on Securities and Financial Services Firms initiated by the IRS in June of 1988. Among the transactions being addressed in the study are LBOs. In this study, LBOs will be viewed from the perspective of those who package them as investment vehicles.

The second action is the assembly of task force of field personnel whose purpose will be to bring information from varying sources together and define compliance problems, if any exist. If compliance problems exist, the task force will determine what remedies are necessary to solve those problems. The task force will study classification procedures currently in use and determine if a modification is needed to help identify LBO transactions, issues and all LBO participants. Also, a system will be devised to get the transactions into the examination stream in a way which would maintain effective examination coordination for participants in different geographic areas. The task force attended the April 24 LBO Industrywide meeting to familiarize themselves with the issues and the complexity of the transactions. The first meeting of the task force is scheduled during the week of June 5. The task force's preliminary recommendations should be available some time early this fall.

b) What resources, in terms of dollars and personnel would be required to effectively review leveraged buyout transactions?

We have insufficient data to answer this question at this time, but specific actions, as I just described, are being taken which will provide us with information to determine what additional resources, if any, are needed to effectively review leveraged buyout transactions.

B. APPEALS AND TAX LITIGATION

1. The estimated inventories of Appeals and Tax Litigation continue to climb in FY 1990. Yet, the Administration requested a decrease of 5 percent in the number of positions.

(a) Why are the case inventories increasing?

Appeals nondocketed disposals are estimated to remain at the FY 1988 level of 52,000 in both FY 1989 and 1990. Actual receipts for FY 1988 totalled 57,364 and estimated receipts for FY 1989 and 1990 are 60,000 work units annually. Due to the fact that receipts are increasing and Appeals Officer staffing is remaining constant, inventories are increasing.

Tax Litigation inventory as of 9/30/88 totalled 71,727. This inventory was some 10,000 cases under the level we projected in the FY 1990 Congressional Budget. The reason for the decrease was that closings in FY 1988, for the first time in recent years, substantially exceeded receipts. Inventories are expected to eventually level off in FY 1989 and FY 1990. Closings will fall off to the point where they will equal receipts because attorneys will be increasingly redeployed to large dollar cases, which take considerably more staff time to close. Attorneys will also be redeployed to assist Examination in the development of large dollar cases. It should be noted that the fall off in case closings will not cause a decrease in the dollars recovered because the average amount recovered per case will continue to increase as we redeploy staffing to large cases.

(b) What can be done to reduce year-end inventories?

The addition of Appeals Officer staffing in the past two years resulted in the predicted reductions of high nondocketed inventories.

Appeals and Legal Services are currently working towards computerization of the workplace, which will expedite the process of disposing of cases in inventory.

(c) How much would these have improved under IRS's budget request for 1,268 additional positions?

Office of Chief Counsel's budget request included 316 additional Appeals Officers and 294 attorneys. We originally estimated that the Appeals Officers would have closed some 10,000 additional nondocketed cases and the attorneys would have closed over 18,000 docketed cases. Our current estimate of the nondocketed closings is still some 10,000 cases. We would estimate significantly fewer docketed closings, but with a higher average dollar value.

2. What will be the impact on IRS's ability to retain qualified attorneys and other tax professionals, if, as projected, the Tax Litigation receipts increase by 7,000 and there is a decrease in the staff level?

The latest projection of the increase in receipts is closer to 1,000 - 3,000 cases. Because we have sufficient attorney staffing to handle the increased receipts, workload pressures are not expected to increase significantly. The greatest impediment to our ability to attract and retain high caliber attorneys is the salary levels, which fall far short of the salaries offered in the private sector. The salary differential is particularly acute in large metropolitan areas.

What is the difference between the starting salary for law school graduates hired by the Chief Counsel's Office and the salary offered by the private sector?

The starting salary for law school graduates joining the Chief Counsel's Office is $28,852 (GS-11 Step 1). This compares with an average starting salary of $35,814 for private sector attorneys who graduated in 1987. (Source: December 30, 1988 release from the National Association for Law Placement). However, for very large firms (over 100 attorneys), the average starting salary for 1987 law school graduates was $53,683. Even for large firms (51 - 100 attorneys), the average starting salary was $46,005.

How does the IRS compete?

The Office of Chief Counsel has taken many steps to recruit the best law students. For example, officials from the National, Regional, and District Counsel offices visit law schools and interview candidates. New recruiting materials highlight non-pay benefits that we offer attorneys, such as case responsibility earlier in their careers than they would receive in the private sector. Other "quality of life" issues are discussed during recruitment, such as excellent training programs and fringe benefits.

3. Is there an increase in the IRS FY 1990 budget which will increase the caseload in the Department of Justice's Tax Division?

There are no increases in Chief Counsel staffing. However, there are many factors which could increase the caseload of the Department of Justice's Tax Division and only some relate to the staffing of either Chief Counsel or other Service enforcement activities.

Is there any coordination between the IRS Treasury and the Department of Justice on this matter during submission of budget requests?

There is no coordination between Treasury and Justice relating to the development of budget submissions. The Office of Management and Budget (OM) coordinates any issues between agencies.

Does IRS think that there should be?

We concur with the Administration's current policy of using OMB to coordinate budget issues between agencies.

C. EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS

1. The number of employee plan determination letters in FY 1990 is expected to double over the FY 1989 level. What will be the impact of the Administration's proposal, which decreases staffing, on IRS's ability to handle the increased employee plan workload?

The increase in the number of determination letters expected to be issued in FY 1990 is a result of the anticipated increase in the number of plans seeking approval of their amendments to conform with the provisions of the Tax Reform Act. Although the staffing level will be somewhat lower in FY 1990, staffing increases received in previous years coupled with the use of accelerated processing methods will enable us to issue determination letters well within the statutory period of 270 days.

RE: FY 1989

2. The IRS FY 1989 budget estimated 359,000 employee plan determination letters would be issued; yet that number is now much lower. IRS expects to issue only 100,000 determination letters in 1989. What accounts for this decrease?

The FY 1989 budget estimate of issuing 359,000 determination letters in FY 1989 was based on the anticipation of the early promulgation of the necessary regulations to implement the Employee Plans provisions of the Tax Reform Act. The FY 1990 budget estimate that only 100,000 such determination letters would be issued in FY 1989, recognized the fact that the promulgation of regulations covering the amendments to the plans was delayed.

3. Why is the FY 1989 audit rate for exempt organizations now estimated at 2.50% rather than the 4.67% rate noted in the FY 1989 budget? How does the audit rate for exempt organizations breakdown by type of exempt organization and by issues under examination?

The estimated coverage rate of 2.50% is below the actual coverage rate achieved during the first six months of FY 1989, specifically 3.04%. Both of these rates are lower than the original estimate of 4.67%. The lower rates resulted primarily from the additional time devoted to conducting sensitive evangelical examinations and conducting the Taxpayer Compliance Measurement Program, addressing the Forms 990-T (Exempt Organization Business

Income Tax Return). Whereas a typical examination requires one agent to devote approximately 20 hours to audit one organization, evangelical examinations can require teams of several agents to devote hundreds of times the normal number of hours to audit interrelated evangelical organizations. Likewise, the complexity of certain unrelated business income tax issues has raised the overall average time per examination case.

An additional factor which has lowered the coverage rate is the unusually high turnover rate we have experienced. The turnover has lowered the overall experience level of our employees and has dictated the diversion of some of our most experienced agents from conducting examinations to training new hires.

The actual examination coverage rate for the first six months of FY 1989 by type of exempt organization is as follows:

- Charitable Organizations 501(c)(3) — 2.24%
- Miscellaneous Organizations 501(c) except (c)(3) — 3.78%
- Farmers Cooperatives 521 and taxable entities — 3.52%
- Composite Average — 3.04%

We do not capture coverage rate data by nature of issue, since almost all examinations involve multiple issues. However, to indicate the nature of our current emphasis on various issues, the following listing of issues to be addressed comes from our initial FY 1989 guidance to our field offices:

- Form 990-T Taxpayer Compliance Measurement
- Form 990-T Nonfilers
- Form 990-T Delinquencies
- Political and Legislative Activities
- Political Action Committees
- Private Schools
- Excise Taxes on Private Foundations
- Employment Taxes

Later guidance placed emphasis on Charitable Contributions.

SECTION III: INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

A. INVESTIGATION

1. The IRS indicated there would be emphasis on the General Enforcement Program (GEP) which investigates offshore banking and tax havens. Since GEP tax fraud investigations initiated are not increasing in 1990, where is the increased emphasis being placed?

The increased emphasis is being placed on identifying and investigating organizations who promote offshore banking activities, rather than individuals. In the past, our efforts in this area have been gauged by treating each taxpayer as a separate investigation. We now feel it is more productive to identify multiple taxpayers involved in these activities through one investigation involving the entire organization.

In essence, the actual number of investigations may not increase in 1990, but the number of taxpayers involved and identified in these activities will likely surpass our 1989 figures.

2. From 1983-1987, the IRS was second only to the Drug Enforcement Agency in investigations initiated in the Organized Crime Drug Enforcement Task Forces and now the Congress has enacted the Omnibus Drug Initiative Act.

(a) How many agents are currently committed to the drug task forces?

At the present, 419 agents support the drug task forces.

(b) How many additional agents will be committed to this effort in FY 1990? Is this increase solely due to new responsibilities assumed under the Omnibus Drug Initiative Act?

We project an increase of 300 agents will be needed to meet our commitment in FY 1990. This increase is solely due to the new responsibilities assumed under the Omnibus Drug Initiative Act.

3. How many special agents will be committed to money laundering investigations? Is this an increase or a decrease over FY 1989 agents?

There will be 329 special agents committed to money laundering investigations during FY 1990. This is the same as our FY 1989 commitment to this program.

B. COLLECTION

1. The FY 1990 budget request for Collection totals 20,804 positions, an increase of 510 positions above the current FY 1989 level. Most of these new positions will be in accounts receivable. Yet, dollars collected from accounts receivable will increase by only $1.3 billion over FY 1989.

(a) What will the accounts receivable inventory be at the end of FY 1990 if the Administration's budget request is approved?

In the President's budget we estimated that there would be $59 billion in delinquent receivables at the end of FY 1990. However, by FY 1990, we will have inplemented some changes to accounts receivable reporting that will affect this total. By FY 1990 we will have a reporting system that will allow us to estimate an allowance for doubtful accounts, that is, those accounts that are not likely to be collected. This will reduce the amount of reported receivables. We are also looking at those accounts that duplicate assessments already in the inventory, such as assessments of the 100% penalty under IRC 6672, to find the best way to eliminate the double counting of those receivables. We will increase the inventory by adding the penalties and interest accrued in delinquent accounts, which are not currently included in the inventory. We have not estimated the net affect of these changes to the inventory.

(b) Price Waterhouse recently completed its study of IRS's accounts receivable inventory. What did they determine were the reasons for the growth in accounts receivable?

Price Waterhouse identified a number of causes for growth in accounts receivable dollar inventory from October 1984 to January 1988. Diverted cases, 100% penalty cases, cases on hold, and incoming cases of individual taxpayer delinquent accounts were major causes.

(c) How much money was lost in FY 1988 due to the expiration of the statute of limitations on collection? How does this compare with FY 1987? How many delinquent accounts does this represent?

In FY 1988, the statute of limitations expired on 634,000 cases worth $2 billion. In FY 1987, $1.2 billion was lost from 611,000 cases. We attribute the increase in the amount lost to two factors. First, in FY 1988, we moved 100% penalty assessments from our manual accounting system (Non-Master File or NMF) to the Individual Master File (IMF). We do not include the NMF cases in the statute expired totals. Over $300

1. (c) (cont'd)
million of the FY 1988 statute expired amount came from cases that were previously on the NMF. Second, we are seeing the effect of the overall growth in the average amount owed on delinquent accounts. The average amount of a case going to statute expiration increased from $2,070 in FY 1987 to $3,181 in FY 1988.

(d) How many of the cases in accounts receivable are awaiting the outcome of a bankruptcy proceeding?

The total number of bankruptcy cases in inventory as of March 31, 1989 was 226,907. This represented $4.6 billion in accounts receivable.

2. In the past, the IRS has suggested that we allow taxpayers to use credit cards to pay their tax liabilities.

(a) IRS testified that a legislative proposal for payment of taxes by credit card is still under active consideration. Does the IRS anticipate forwarding a proposal to the Congress in the near future? If so, when?

A legislative proposal to amend the Internal Revenue Code to permit acceptance of tax payments through the use of a credit card was initially submitted by the Administration on September 13, 1988. No action was taken on this proposal during the 100th Congress. The current Administration has the same proposal under consideration for submission to the 101st Congress.

(b) If necessary legislation were adopted, how long would it take to implement this program?

Once legislation is passed, we will evaluate the use of credit cards at a pilot site before we consider nationwide implementation. It should take about 18 months to establish a pilot program, which would then run for a year in order to thoroughly test the concept and work out any problems. We would be able to expand credit card processing to the rest of the nation six months after completing the pilot. Assuming that the pilot installation is successful, it would take three years to implement credit card processing.

(c) Does the IRS still estimate the cost to the federal government associated with credit card payments at $4.3 million?

Yes. We estimate that as the initial cost, for equipment and in-house processing. That does not include the discount fee that would be charged by the vendors providing the credit card services. This fee would be negotiated after enabling legislation is passed. One purpose of running a pilot program will be to determine from experience the actual costs and benefits of the program.

C. TAXPAYER SERVICE

4. What resources are necessary to raise the telephone accuracy level to 90%?

We have been working for some time on a variety of actions which we feel will enable us to attain our ambitious goal of providing every taxpayer with a correct answer.

- We have improved the training we provide to our assistors. We now spend additional time on those subjects which traditionally present our assistors with special problems.
- We have increased the involvement of our managers in the toll-free telephone assistance process.
- We have enhanced the telephone equipment used by our assistors and we have provided our assistors with special job aids which deal with a variety of tax law issues.
- We have expanded our automated taxpayer assistance program -- called Tele-Tax -- to include additional tax law information.
- We have instituted a nationwide system for testing the accuracy of the service we provide, diagnosing problems and taking immediate corrective action.

We do not believe there is a direct one-to-one correlation between resources and the level of accuracy which we attain. The accuracy levels we achieve are the end product of a variety of initiatives and actions such as those cited above. As specific actions to improve accuracy are implemented, we will adjust our overall resource requirements accordingly.

RE: FY 1989

5. IRS's budget submission indicated a need in FY 1989, this year, for $54 million to improve taxpayer service. The Administration did not approve the supplemental request.

(a) Does IRS have the resources this year to fully fund taxpayer service?

IRS has adequate resources in FY 1989 to fund taxpayer service.

(b) If so, where did those resources come from?

Approximately $58 million was reallocated to the taxpayer service function in FY 1989 from programs with a lower priority.

5. (cont'd)
(c) What could the IRS have done with the $54 million in supplemental resources requested?

The IRS proposed FY 1989 supplemental contained $52.3 million to improve taxpayer service accuracy. This amount would have funded an additional 1,300 positions for taxpayer service ($43.8 million), conversion of 700 temporary employees to permanent status ($1.5 million), upgrading 1,000 taxpayer service representatives to taxpayer service specialists ($5.1 million) and increased training for taxpayer service managers ($1.9 million).

6. We have received reports that the IRS will be closing the taxpayer assistance office in Yonkers, New York.

(a) How many taxpayers were assisted at this office in the 1988 filing season and 1989 filing season?

At the Yonkers, New York office, during the 1988 filing season, Taxpayer Service assisted 5,765 taxpayers. Although Taxpayer Service did not staff the Yonkers office in the 1989 filing season, we estimate that 680 taxpayers were assisted by the Tax Counseling for the Elderly volunteer assistance program.

(b) Is this closure due to funding shortages?

Given budget resources, we are looking at the best way to assist taxpayers throughout the Manhattan District, including Yonkers. As a part of that review, we looked at the type and numbers of taxpayers visiting all offices, including Yonkers, and felt we could more effectively and efficiently provide taxpayer assistance through other alternative means such as taxpayer education programs.

In further discussions with the city of Yonkers and Congressman Engel's office, we are reviewing other alternatives for Taxpayer Service, including the possibility of a satellite office in shared space with the city, or a state or federal agency.

(c) Will any other offices be closed this year? If so, how many taxpayers will be affected?

(d) Will any offices need to be closed under the 1990 get proposal? If so, how many taxpayers will be affected?

At the present time, we are not aware of any other offices that have been closed, nor are we aware of any offices to be closed in FY 1990.

SECTION IV: RETURNS PROCESSING AND COMPUTERS

1. Although the Administration's budget request increases the number of positions in Returns Processing and Computer Services, IRS had requested an increase which was three times that which the Administration submitted.

   (a) Why did the IRS request 3,007 more employees for FY 1990 than authorized for FY 1989?

   (b) What is the impact of the Administration's failure to approve IRS's request?

   (a) In its original request for resource increases in FY 1990, the Service requested an additional 2,663 FTE in Returns Processing and 1,618 FTE in Computer Services.

   The Returns Processing increases were principally requested to process additional tax returns and issue refunds (794 FTE), reconcile Combined Annual Wage Reports with the Social Security Administration (417 FTE), improve Service Center correspondence to taxpayers (202 FTE), continue to work down the backlog in Currency Transaction Reports processing (176 FTE), and restore a baseline shortage of 1,047 FTE. Also included were resources for additional Federal Tax Deposit Penalty work, other Revenue Initiatives and adjustments. The balance of the increase was for smaller initiatives.

   Computer Services requested the 1,618 FTE increase primarily to support the Service's Field efforts. This activity's function is responsible for providing the necessary support for the Service's information systems and major tax processing systems located in the Regions, Districts and Service Centers. Among the major projects supported are the Communication Replacement System and the Service Center Replacement System.

   (b) The FY 1990 Budget to Congress reflected an increase of only 1,274 FTE, 912 FTE for Returns Processing and 362 FTE for Computer Services. To cover the shortfall of 3,007 FTE, the Service will redirect resources from other functional areas to provide for the necessary staffing levels in each activity.

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We have been working for some time on a variety of actions which we feel will enable us to attain our ambitious goal of providing very taxpayer with a correct answer.

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(b) If so, where did those resources come from?

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A. RETURNS PROCESSING

1. IRS projects 5 million additional returns will be filed next year. How will the 900 new positions accommodate those additional returns when 1,800 new positions were needed in the 1988 filing season to process a little over 4 million additional returns?

In the budget for FY 1990, IRS requested 794 FTEs to process some 5 million additional tax returns due to population growth. This compares to 726 FTEs requested for FY 1989 to process an additional 4 million returns The Service is now reevaluating the returns projections for next year based on current filing period experience.

3. There are serious questions about the training and retention of returns processing personnel.:

(a) Does the budget proposal provide the resources to improve the quality of returns processing?

Although we did not receive all we requested, the budget proposal will help us improve the quality of returns processing.

(b) If not, how is the IRS improving the training of personnel to ensure fewer errors?

Within existing parameters, some of our continuing efforts to improve the training of personnel include: reviewing the ratio of permanent positions in the service centers; collecting, analyzing and measuring program effectiveness; tracking and measuring training accomplishments; and developing state-of-the-art correspondence software.

4. What is the IRS policy for handling and monitoring the status of bankruptcy Unpostables at the service centers? How much of the total Unpostables inventory is represented by accounts in bankruptcy?

Bankruptcy accounts are identified and monitored by the district office, where a code is input to the taxpayer's master file account. This code prevents assessments from going against the account. If an assessment is subsequently sent to the account, the master file intercepts and a list is produced and sent to the Unpostable function. (A copy of the list is also sent to the district office for monitoring of the account.) The Unpostable function requests the assessment document from the File function and maintains it in a suspense file. When the bankruptcy is lifted, the district office notifies the Unpostable function in the service center to process the assessment document, which is then pulled from the suspense file and released to the master file.

Bankruptcy cases represent 11.3% of the unpostable inventory.

A. RETURNS PROCESSING (cont'd)

5. Has the IRS reached an agreement with the Social Security Administration (SSA) to modify the July 12, 1988 Memorandum of Understanding Combined Annual Wage Reporting such that, on a case-by-case basis, SSA will identify large volume FY 1985 and FY 1986 non-tax cases and provide them to the IRS for penalty consideration?

IRS and SSA have reached a verbal agreement under which, on a case-by-case basis, IRS will work large dollar volume Tax Year (TY) 1985 and TY 1986 non-revenue cases that are returned by SSA. This agreement was included in the yearly review of the Combined Annual Wage Reporting (CAWR) program, entitled Annual Review, Memorandum of Understanding, Combined Annual Wage Reporting.

(a) If so, how many of these cases does the IRS expect to receive from SSA?

Based on our conversations with SSA staff, we do not expect the volume of these cases to be very large.

(b) If SSA refers the cases to the IRS on or before November 1, 1989, dos the IRS have the resources and necessary programs in place to process the FY 1985 cases prior to the running of the applicable statute of limitations?

IRS is committed to providing the resources necessary to work these cases, and we are developing procedures for working these cases as part of our CAWR program. We are planning to contact employers on the TY 1985 and TY 1986 cases, but there is some question as to IRS's ability to penalize employers for failure to file Forms W-2 for years in which the three year statute of limitations has run. The Code provisions concerning the three year statute of limitations on collection and assessment are unclear in this area. The statute would have expired in early 1989 for TY 1985 Forms W-2, which were due to be filed by January 31, 1986. Also, since employers are only required to retain employment tax records for four years, it is possible that TY 1985 cases could prove to be a problem (i.e., records for TY 1985 need only be kept until February, 1990). For these reasons, we are trying to move quickly on these cases and plan to work them as soon we receive them from SSA.

B. COMPUTER OPERATIONS

1. When will the IRS reach a decision on the basic "system architecture" for a new computer system?

The IRS is currently developing, with contractual support, a target architecture for the Tax Systems Modernization effort. This target architecture will include a user requirements analysis, logical design, physical design, telecommunications and security architecture, and cost/benefit analysis. The target architecture will serve as the blueprint that IRS will follow to lead its way in the use of information technology into the 21st century. The blueprint will describe, at a high level, the way IRS will conduct its business and the physical architecture (computers, software, telecommunications) that will support this way of doing business. It will incorporate the results of all ongoing or completed initiatives. The target architecture will be identified in the Fall of 1989.

2. For the past two years the GAO has testified that the IRS data processing systems will begin to encounter capacity problems and be unable to fully process the necessary workload beginning sometime between 1992 and 1994. How long will it take the IRS to acquire and make operational the computer systems called for under the tax system modernization program?

Although the IRS' modernization plans span about ten years, interim steps are underway to relieve the capacity problems anticipated in the mid-1990's.

The Service Center Support System (SCSS) contract will be awarded in the second quarter FY 1991 and the equipment will be installed in all the IRS Service Centers in the second quarter FY 1993. The ADP Support Service Contract has been advertised, competed and evaluated and will be awarded soon. This contract will be used to transfer some of the applications presently on the Univac System to the SCSS. This contract will also be used to assist the IRS in the redesign of the computer applications for the SCSS. Also a contract will be awarded in the fourth quarter FY 1991 for the first phase of Corporate Systems Mirror Image Acquisition (CSMIA). This phase of CSMIA will put corporate files on line for query only and will reduce the local Service Center Taxpayer Information File (TIF) processing by 10-15 percent. These three contracts will be used as the platform basis to relieve some of the processing on the Univac system during the 1992 and 1994 timeframe.

3. How much will it cost to design and acquire the new computer systems called for under the IRS' Tax System Modernization program?

IRS estimates total costs over a ten year period to be approximately $4 to $5 billion. These funds include the costs of all ISD initiatives/projects for the entirety of their respective system's lives. This figure is based upon the development, implementation, and operation costs over and above the base staffing and operating costs of the current tax processing system.

4. In FY 1989 Tax System Modernization appropriation was $80 million. In FY 1990 it had risen to $234 million. How much of this increase represents increased expenditures and how much of it is the result of reclassifying pre-existing computer projects as part of Tax System Modernization?

In the FY 1991 budget submission to Treasury, the Information Systems Policy Board classified the projects under Tax System Modernization (TSM). TSM is among the top priorities in the FY 1991 budget. The Tax System Modernization appropriation for Information Systems Development (ISD) was $92 million in FY 1989 and $141 million in FY 1990. In FY 1990, there were no pre-existing computer projects reclassified as part of Tax System Modernization.

5. In terms of cost, what are the ten largest IRS computer modernization projects, and which of them are included in Tax System Modernization?

The ten computer modernization projects included in Tax System Modernization are as follows:

- Corporate Files On-Line
- Service Center Support System
- Input Processing Redesign
- Full Utilization of Electronic Filing System
- Long-Term Redesign of the Tax Administration System
- Electronic Deposit Processing System
- Servicewide Citator System
- ISD Mission Support
- Corporate Systems Mirror Image Acquisition
- Service Center Departmental Applications

What determines which projects are included in Tax System Modernization?

The Information System Policy Board is responsible for formulating the Service's information systems policy; establishing long-term information systems strategies; and providing guidance and overall direction for information systems at the IRS. In reviewing the Information Systems Budget the Board ranks initiatives within the context of priorities established by the IRS.

Further, the Board is responsible for providing approval and oversight for the formulation, organization, and development of major information systems initiatives. This includes determining which information systems require Board sanction, which phases of the development process require Board approval, criteria for receiving approval, whether a project office should be established, ensuring that information systems development is conducted in accordance with government directives, and when necessary terminating unsatisfactory projects. For initiatives to be included under the modernization umbrella they must: substantially alter the current operations of the IRS, resulting in improved quality and timeliness of service to taxpayers; and, be directly associated with the corporate on-line data bases. (Corporate files would include tax information that more than one authorized IRS employee or function might use.)

The ISPB is chaired by the Deputy Commissioner (Planning and Resources) and the following members:

- Assistant Commissioner (Information Systems Development permanent member
- One Regional Commissioner (rotating two year term)
- One Assistant Commissioner from Operations (rotating two year term)
- Assistant Commissioner (Planning Finance and Research) participates as a member during review of the Information Systems Plan and Information Systems Budget.

6. The current Budget documents do not provide sufficient detail to al the subcommittee to track the progress the Service is making in its effo to modernize it's computer operations. Please provide to the Subcommitt an accounting of the individual modernization initiatives and acquisitic currently underway, including their expected completion dates and project annual costs.

The costs figures as stated for each initiative includes the cost associated with the budget initiatives (i.e. staffing, acquisition cost overtime, travel etc.).

The following initiatives are planned for the System Modernizatio effort:

On Line Entity (OLE) will serve as the first application of the Corporate Files On Line (CFOL). This will provide a system that meets user needs for access to a national entity file and improved validation of document information at point of entry. This system will be fully implemented for the 1990 tax filing season. The IRS is in the process of purchasing disk storage devices and network interfaces for this system. The estimated budget amount for FY90 in CFOL is $11.7M.

The Service Center Support System (SCSS) will support the major service center processing which is now accomplished on the Univac Systems in the Service Centers. The SCSS will support most of the departmental systems that will be implemented throughout the systems modernization effort. These systems will include: Integrated Management System, Automated Under Report System, Electronic Funds Transfer, and Service Center Compliance Applications, etc. The SCSS will be installed starting in the 2nd quarter FY 92. The estimated budget amount in IS08 for FY 90 is $17M.

The Corporate Systems Mirror Image Acquisitions will be accomplished in two Phases. Phase I will replace all equipment in the Detroit Computer Center (DCC) and the Martinsburg Computing Center (MCC) with plug compatible equipment during FY 91. All current processing will be migrated to these systems. This will allow for the design and implementation of Corporate Files On-Line applications and a Program Development System and all current workload. Phase II will provide full and open competition to replace all hardware, software, and maintenance, etc. at MCC and DCC. This will provide the processing system to support the redesign of the Service's corporate processing. Phase I and II systems will operate concurrently as the current system is redesigned on the Phase II system. As the redesigned system goes fully operational on Phase II, it will be phased off of Phase I. Phase II will be installed in the FY 93-94 time frame with full migration completed around 1st quarter FY99.

The Integrated Input Processing Acquisitions will include the Document Processing System (DPS), and the Cash Management System and the Information Returns Program. This will interface with the SCSS via the Local Area Networks at the Service Centers. The pilot system for DPS is scheduled to be installed in the 2nd quarter FY 94, with full implementation scheduled by 2nd quarter FY 98.

The Integration Service Support Contract (ISC) will be used to provide technical support in the integration of all major systems within the systems modernization effort. This is scheduled to be awarded in the 4th quarter
FY 90.

Citator will be a service wide data base system for research. The current system is a paper intensive tax administration and legal research systems used by employees today. The departmental terminals/workstations used to access SCSS will be used to access this system. The data will be maintained on IRS data bases and in Compact Disc-Read Only Memory (CD-ROM) format. The system is scheduled to be operational 2nd quarter FY92. The estimated acquisition costs in FY90 is $8.6M.

The Electronic Filing System (EFS) provides the capability to automate the receiving, sorting, blocking, numbering, coding, editing and transcribing of returns filed electronically by automated return preparers. EFS also includes an optical disc archival system which allows virtually instantaneous image storage and retrieval of tax returns. EFS will be fully implemented for the 1991 tax filing season. The estimated acquisition costs in FY 90 is $16.4M.

The Electronic Federal Tax Deposit System (EFTD) is an automated system that will allow taxpayers to electronically transfer money from their Bank accounts to Treasury's account. The concept states that the Federal Reserve Bank will transfer the Funds to Treasury on the same day the Deposit is due instead of three days after the due date. This will eventually eliminate the one day free use of funds by depositaries at a savings to the government of $200 million a year. EFTD is scheduled to be fully implemented by the 4th quarter FY 95. The estimated acquisition costs in FY90 is $1.9M.

The following acquisitions which are related to, but not included in Tax Systems Modernization, are currently underway:

Treasury Multiuser Acquisition Contract (TMAC) will provide multiuser systems, workstations, software, local area networks (LAN) and other communications capability for the Department of Treasury and its bureaus. These systems will tie into the Service Center Support System at the Service Centers via LANs. The RFP is currently on the street and vendor responses are due to the government on June 5, 1989. The expected contract award date is 4th quarter FY90. This contract will be used by the IRS and other Treasury Bureaus as the need arises.

The Departmental Microcomputer Contract (DMAC) will provide a catalog of microcomputer hardware, software and maintenance services for the Treasury Department and its Bureaus. The microcomputers procured by the IRS from this contract will be used within the Service Centers to access the Service Center Support System and the Corporate Systems Mirror Image Acquisition Systems at MCC and DCC. The estimated contract award date is the 1st quarter FY 90. This contract will be used by IRS and other Treasury Bureaus to procure microcomputers and other equipment on an as needed basis.

The Integrated Collection System (ICS) will be a computer based on-line processing system utilizing mainframes at 20 sites. This system will provide for direct computer links to 650 sites. ICS will have access to various files within the Service Center Support System and will also have access to the CFOL Master Files in FY 1993. ICS will install a Program Development System at MCC in the fourth quarter of FY 1990 and will begin installation of all other sites in FY 1991 to be completed within FY 1993. The estimated budget amount for FY 1990 is $11.8 million.

The Automated Data Processing Support Services (ADPSS) contract, is a $500 million seven-year contract. It will be used to convert any applications to the new systems and will also be used for the design and development of all new applications for the system modernization effort. The award has been protested and is in litigation at this time.

7. For several years GAO has found that noncompetitive pay and limited training opportunities are hindering Federal efforts to recruit and retain computer personnel.

(a) How serious is this problem for the IRS?

Noncompetitive pay has limited IRS' ability to recruit college graduates in the computer-related field. Most of the better graduates choose to work in private industry because starting salaries are much higher for jobs such as computer programmers. As a result, the quality of our entry level computer personnel has suffered.

(b) Has the lack of ability to recruit and retain computer personnel contributed to the delays in IRS computer modernization initiatives, such as the Service Center Replacement System, the Communications Replacement System, and the Automated Examination System?

Problems with recruitment have not affected major programs. We are able to utilize our more experienced employees to support major initiatives.

(c) What steps has the Service taken to improve its ability to compete with the private sector in retaining key computer specialists, and what additional steps should be considered?

The Office of Personnel Management has granted the IRS direct hiring authority for hiring computer specialists. This has helped us considerably in targeting our recruitment efforts towards college graduates and hiring in particular geographic areas. Direct hiring also saves time for the Service and potential employees.

Because our starting salaries are much lower than private industry, a study should be conducted on salary rates paid in various geographical areas for computer specialists. Based on these findings, we should adjust our salary rates accordingly.

SECTION V: EXECUTIVE DIRECTION AND MANAGEMENT SERVICES

1. Both IRS and Treasury had requested more than 600 positions for Executive Direction and Management Services than the Administration proposed in the FY 1990 budget. Where were those positions needed?

The 600 positions were not eliminated from the Administration proposal. These resources are being transferred from Management Services to Computer Services. This action was taken to consolidate the two IRS data processing sites under the leadership of one organization to enhance the Service's ability to affect the "mirror image" concept. This process provides for backup tax processing between the Martinsburg, West Virginia and Detroit, Michigan computing centers.

2. What is the FY 1990 funding for the Statistics of Income (SOI) Division in the Administration's budget submission?

$22,614,000 (or 544 staff years).

What funding level did the IRS request from Treasury?

$23,783,000 (or 561 staff years)

How would SOI's activities and the timeliness of responses have differed in FY 1990 under the IRS's budget request?

Ongoing SOI activities will not be curtailed as such; however new program initiatives in the excise tax and employee plan areas will have to be phased in much more slowly. In addition there will be a delay in the modernization of SOI's computer system. This system when fully operational will link the SOI Division with its field processing sites and its principal customers. Lack of adequate SOI computer power has contributed significantly to program costs, processing inefficiences, and timing delays.

How does the Administration's FY 1990 budget request compare with the FY 1988 and FY 1989 funding level for SOI?

Fiscal Year	Current dollars ($ millions)	Constant dollars 1/ ($ millions)
FY 1990	22.6	19.6
FY 1989	21.7	19.4
FY 1988	16.0	14.8
For comparison -		
FY-1987	15.5	14.8
FY 1986	14.1	13.6
FY 1985	19.0	19.0

1/ Constant dollars are based on 1985 using the Federal non-defense non-pay purchases deflator for each year.

What SOI activities involving data collection and analysis have been reduced or eliminated in recent years due to a lack of resources?

Budget has grown since FY 1986 when a 25 percent cut was sustained. SOI, however, is now essentially put back to its FY 1985 level, but has a much greater work load due to tax reform. Increases since 1986 have been used to meet Office of Tax Analysis (OTA) requirements, including:

- o needs associated with the impending tax reform;
- o needs emanating from tax reform; and
- o needs in anticipation of the next tax reform.

SECTION V: EXECUTIVE DIRECTION AND MANAGEMENT SERVICES - (Cont.)

Some examples of the effect of a lack of resources are shown below:

- SOI has been slow to respond to requests to start new programs on excise taxes, employees plans, and several special subjects growing out of tax reform, e.g., alternative minimum taxes, passive losses, and capital gains.

- SOI sample sizes, especially for corporations, have not grown to levels requested by OTA (and also by the Commerce Department which uses SOI in estimating the GNP).

- Plans for more timely data on corporations and individuals have been put on hold.

- Detailed geographic data by State or local area have been eliminated.

- SOI publications have been reduced in number and size and confidentiality issues that now limit release of more public use data files have not been fully addressed.

As already noted, perhaps the most important casualty of SOI's current budget is the lack of resources to modernize its statistical and computational methods.

3. The Subcommittee's hearings on the filing season revealed that the availability of forms is a problem again this year. Management Services is responsible for the printing and distribution of tax forms.

   (a) Are the continuing form availability problems due to the reduction in staffing in this account?

   Staffing cutbacks related to the $360 million shortfall in FY 1989 have had only a limited impact on our publishing services/forms distribution program. Although the staffing reduction caused some minor problems, the principal cause of forms availability problems in 1989 was late approval of forms due to the late passage of the Technical and Miscellaneous Revenue Act of 1988.

   (b) How will a decrease in positions in FY 1990 affect the National Office's oversight of form availability?

   The FY 1990 Budget now before the Congress does not reflect a staffing reduction for the oversight of forms availability. However, any future reduction to the existing headquarters distribution staff would make it virtually impossible to achieve even a minimal level of oversight. The task of monitoring forms availability, during peak, requires the coordination of efforts with the Government Printing Office (GPO), contractors, shippers and other IRS offices. With a reduction in staff, we could not adequately monitor forms availability and maintain an acceptable level of quality in our daily publishing services operations.

SECTION V: EXECUTIVE DIRECTION AND MANAGEMENT SERVICES

4. The budget proposal for FY 1990 will reduce Management Services staffing to half the level it was in 1988. How could such a reduction occur without affecting some IRS functions and how will this reduction affect overall IRS operations?

   The reduction in staffing in this appropriation reflects the organizational transfer of the Detroit Computing Center, formerly called the IRS Data Center, to Computer Services. Computer Services is a budget activity, under the Processing Tax Returns Appropriation. Some 600 average positions, including centralized payroll operations and research efforts, including the Tax Compliance Measurement Program, are being transferred. There will be no adverse impact on IRS operations. As a matter of fact, this action should result in improved tax administration since the Detroit Computing Center will be a "mirror image" of the Martinsburg Computing Center for backup tax processing capability.

Chairman PICKLE. Let me see. I believe that completes the testimony for the IRS this morning. Thank you so very much.

Mr. MURPHY. Thank you, Mr. Chairman.

Chairman PICKLE. I'm going to depart from my schedule of witnesses, with the understanding of my friend, Mr. Gibbs, and ask Judge Nims if he would come forward at this time. I understand court is in session, and you may need to get on back.

Is Judge Nims, chief judge of the Tax Court, here now? Judge, why don't you come forward and present your testimony, and you then can go back to the court? You have a court session to attend, and Mr. Gibbs is just representing some client maybe. [Laughter.]

Mr. Nims, the Third, is the chief judge of the U.S. Tax Court, and we will be pleased to receive your statement now, Judge Nims.

STATEMENT OF HON. ARTHUR L. NIMS III, CHIEF JUDGE U.S. TAX COURT, ACCOMPANIED BY CHARLES CASAZZA, CLERK OF THE COURT

Judge NIMS. Thank you, Mr. Chairman.

On my left is Charles Casazza, the clerk of the Tax Court.

Mr. Chairman, I know your time is precious this morning and I will try to be very brief.

My name is Arthur Nims. I'm chief judge of the Tax Court. I would like to make a few remarks this morning and then answer any questions that you or other members of the committee might have.

Also I would ask that my written statement, submitted last Friday, be made part of the record of this hearing.

Chairman PICKLE. Without objection, Judge, it certainly will be made part of the record. Thank you, sir.

Judge NIMS. Mr. Chairman and members, since 1979, when I took office as a judge of the Tax Court, I've witnessed dramatic shifts in the inventory of cases before our court. At the end of fiscal 1979, 10 years ago, just over 27,000 cases were pending before the court. Within 7 years, the inventory level increased by more than 200 percent to approximately 84,000 cases.

Since those record high levels 2½ years ago, however, the court has seen another dramatic, although somewhat smaller, shift in its inventory, and that movement has been promising. Although the court faced a record yearend inventory of 83,686 cases at the close of fiscal 1986, the case level was down to 81,000 by the end of fiscal 1987. The decrease was small but significant because it was the first time in 20 years that there had been an actual reduction in pending cases from one year to the next.

I am pleased to report that during fiscal year 1988, the court had a truly significant drop in its caseload, a 14,000-case decrease, which meant that the court began the current fiscal year with approximately 67,000 cases pending, and already we're seeing that fiscal 1989 should produce a further reduction in the inventory level.

As of March 30, 1989, 1 day before the end of the quarter, 59,609 cases were pending before the court. By the end of this fiscal year, we hope to see that number at 55,000 or perhaps even lower.

The reduction is attributable to a number of factors. We have seen not only an increase in closings but also a significant decline in the number of petitions being filed in the court. Many parties deserve credit for this turn of events. Congressional action, particularly the enactment of the TEFRA partnership provisions, has reduced the number of new cases. The Internal Revenue Service's settlement policy for cases at the predocketing stage has brought down the number of new filings as well. And better management by the Tax Court itself has resulted in significant increase in closings during the last 2 fiscal years.

For the current year and the next, we expect the progress to continue. Beyond that point, we are uncertain about possible changes in the caseload. The Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988 will undoubtedly result in new litigation in the court. For now, however, we cannot estimate the impact of those statutes.

Turning to the question of resources, in our judgment, the request for $28,120,000 in funding, and 350 permanent positions for fiscal year 1990 will be sufficient for the court to fulfill its responsibilities. If Congress endorses the full amount of our appropriations request, the court will be able to continue its efforts to further reduce the number of cases on our docket.

Our goal is to render decisions promptly, but also after giving careful attention to the matters before us and the importance of the precedents we establish in the area of Federal tax law.

Mr. Chairman and members of the committee, that concludes my remarks. I appreciate the opportunity to appear before you today, and I would be pleased to answer any questions you might have.

[The statement of Judge Nims follows:]

Statement of Arthur L. Nims III, Chief Judge, U.S. Tax Court

Mr. Chairman and members of the Subcommittee, I appreciate your invitation to appear today to discuss the Tax Court's caseload and the Court's budget request for fiscal year 1990.

DURING FY 1988, THE TAX COURT'S INVENTORY DECREASED BY 14,000 CASES, AND A FURTHER REDUCTION IS EXPECTED IN FY 1989

As you know, this is the third time that the Chief Judge of the Tax Court has testified before your Subcommittee concerning the Court's inventory and the adequacy of the Court's resources. In April, 1987, when the first hearing of this kind was held, the situation confronting the Court was somewhat disheartening. Although the Court was managing its inventory on a current basis -- 80 percent of the pending cases had been initiated within the two preceding years -- the number of cases on the Court's docket was large enough to raise some concern.

At the end of fiscal year 1986, the Court faced a record year-end inventory of 83,686 cases. Although the Court quickly made progress in reducing that total, there were still approximately 80,000 cases pending in April, 1987, when the Court submitted its first report to the Subcommittee. There were many factors contributing to the inventory level -- some beyond the Court's control. For example, a staggering 48,000 cases were filed in fiscal year 1986 alone. Also, the Court was considering many complex tax shelter cases which, once decided, would dispose of hundreds or even thousands of dockets. Still, there was a need for the Court to improve its case management techniques and to make some progress in reducing its workload.

Last April, then Chief Judge Samuel B. Sterrett reported to the Subcommittee that at the close of fiscal year 1987, the Court had reduced its inventory below the total number of cases pending at the end of the previous year, the first time that had occurred in more than 20 years. Today, I am pleased to report that the Court has achieved not only a further reduction, but quite a substantial reduction, in its caseload.

During fiscal year 1988, the Court's inventory decreased by 14,000 cases, closing the year with 67,491 dockets pending. As of March 30, 1989, we are even further below that level, with 59,609 cases on our docket. Thus far in fiscal year 1989, we are averaging approximately 2,300 filings per month and disposing of 3,600 dockets monthly. If this pattern continues, and even allowing that the heaviest filing months are still before us, we estimate an inventory of approximately 55,000 cases, perhaps less, by the end of the 1989 fiscal year.

The substantial diminution in the Court's inventory results from a combination of increased closings and fewer new filings. During fiscal year 1987, the Court closed what was then a record high of more than 45,000 cases. During fiscal year 1988, we exceeded that number with 47,165 closings. While predictions can be risky, we are estimating that the Court will dispose of close to 45,000 additional cases by the end of this fiscal year.

Of course, opinions and settlements are only part of the equation. During the last two fiscal years, we have also seen a reversal in what had been successive annual increases in the number of new cases. As mentioned earlier, over 48,000 petitions were filed in fiscal year 1986. In fiscal 1987, that number was under 43,000, and during fiscal year 1988, fewer than 33,000 cases were docketed. That represents a 32 percent reduction in annual filings within just the last two fiscal years.

While the statistics themselves reveal an improvement in the Court's inventory, a careful analysis of the numbers provides even further evidence that the caseload before the Court is approaching a more manageable level. The total current docket of 59,609 cases overstates the number of cases that for practical

purposes are awaiting action by the Tax Court's judges and special trial judges. Between 20,000 to 25,000 dockets out of the total number pending belong to tax shelter groups that are governed by "test" cases in which the Court has already published opinions. Although many of the parties have filed stipulations to be bound by the test cases, the dockets are still part of the Court's inventory because either (1) the test case has been appealed and final action has not been taken at the appellate level, or (2) the parties have not yet submitted their computations reflecting the agreed tax liability. Thus, while the Court has made its final determination on a large portion of the pending tax shelter caseload, the dockets must still remain as part of the inventory.

Although the Court acknowledges considerable progress in reducing its inventory over the last two years, we are careful not to be overconfident about what lies ahead. The Court faces significant challenges in many of the non-tax shelter cases pending on our docket. There are difficult and technical issues to be addressed and time-consuming trials to be scheduled.

Furthermore, while new filings are expected to remain level during this year and the next, the Court could face substantial new litigation in the ensuing years. Both the Tax Reform Act of 1986 ("TRA '86") and the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") will undoubtedly result in new issues for the Tax Court to decide. We have not yet felt the effects of those statutes because there is always some delay before cases involving new legislation reach the Court. As you know, audits must first be conducted by the Internal Revenue Service and a deficiency notice must be sent before a taxpayer can begin a case in the Tax Court. Although it has not yet occurred, we anticipate litigation under TRA '86 and TAMRA, and we are aware that the announced increase in activity by the IRS in large case audits may result in the Court receiving a number of larger and more complex cases.

Accordingly, while the Court expects case filings for the next two years to remain level, estimates beyond that point are difficult to make, and the Court is therefore somewhat cautious about predicting the future.

THE TAX COURT'S BUDGET REQUEST FOR FY 1990 IS SUFFICIENT FOR THE COURT TO FULFILL ITS MISSION

In your invitation, you asked that I address the sufficiency of the proposed fiscal year 1990 budget for the Tax Court. In January, 1989, the Court submitted to the House and Senate Committees on Appropriations, a fiscal year 1990 request for $28,120,000 and 350 permanent positions. After adjusting downward for a special building improvement project -- a one-time appropriation in fiscal 1989 -- the request for fiscal year 1990 is the same as the Court's appropriation for fiscal year 1989. It represents our prudent judgment as to the funding and personnel needed to carry out the work of the Court.

The Court's decision not to seek an increase in funding for fiscal year 1990 was based upon our recognition of the constraints within the federal budget and an assessment that the costs associated with inflation could be borne without having a detrimental effect on the operations of the Court. In order to maintain the 1990 budget at the 1989 level, the Court will be required to absorb approximately $103,000 in inflation costs. We believe this can be done without affecting the quality, timeliness or effectiveness of our work.

The House and Senate Appropriations Committees have historically approved the funds needed by the Court to carry out its work. Of course, in 1987, this Subcommittee was successful in assuring that the Court had additional resources when the

caseload had reached a substantial level. An increase in the number of personnel authorized for the Court was achieved through your assistance and we are grateful for that.

Within the last five weeks, I have testified before the House and Senate Appropriations Subcommittees with jurisdiction over the Court's budget. The Court has provided the Subcommittees with information on the Court's operations and our proposed expenditures for the 1990 fiscal year. We are hopeful that Congress will endorse the full amount of our appropriations request. In our judgment, the Court's fiscal year 1990 request of $28,120,000 is sufficient to operate the Court efficiently and effectively, and if given those resources, we will be able to continue our efforts to further reduce the Tax Court's inventory.

CONCLUSION

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity you have given me to discuss the Court's caseload and the outlook for our fiscal year 1990 budget. I am pleased and proud to report that the Court's inventory has decreased by more than 24,000 cases in the last two and one-half years. If Congress approves the Court's FY 1990 budget request, we will have sufficient resources to work toward further reductions in our caseload, keeping in mind that our objective is to dispose of cases in a prompt fashion while giving careful consideration to the matters before us and the important role we play in establishing the body of federal tax law.

On behalf of the Tax Court, I thank the Subcommittee for its interest in the work of the Court.

Chairman PICKLE. Judge, thank you. I'm impressed with the fact that your workload with respect to cases filed and awaiting trial is going down.

I noticed that from 1987 the actual cases pending went from 81,000 down to 67,550.

Now, you said that several factors explain this decrease. One of them, I noticed you said, was that the number of petitions that had actually been filed declined, perhaps due to the tax bill a few years ago.

Can you add any further comment? Why are the caseloads decreasing and why is your docket becoming more current?

Judge NIMS. Well, one thing I think is significant, which I mentioned, is the TEFRA partnership provisions which Congress enacted in 1982, I believe it was. We are just now beginning to feel the impact of that very beneficial law because investors no longer have to individually petition the Tax Court. One partnership can file one petition which may cover anywhere from 10 to 100 to 1,000 investors in just one petition.

Chairman PICKLE. Yes.

Judge NIMS. So that's reduced very dramatically the number of petitions. We have about 2,600 of those cases pending at the present time.

Chairman PICKLE. Well, that's encouraging. And I'm sure the committee finds that encouraging.

In previous testimony by other judges and representatives of the Tax Court, the numbers were high, they weren't very concerned about it, and they didn't think they need extra help. But the laws we put into effect are now catching up and you are beginning to see these cases decline, and that's encouraging to us.

Can you tell me for my own information, I've often wondered, what's the average time lag between the docketing of a case with the court and the trial of a case, regular cases?

Judge NIMS. Well, that depends partly on the nature of the case. Small cases—these are the cases that are heard by our special trial judges—are taking about a year from the time they're filed to the time that judges can dispose of them.

Chairman PICKLE. About 1 year.

Judge NIMS. Yes.

Chairman PICKLE. What about a regular case?

Judge NIMS. The cases that are more complicated, that may have more than one issue, according to my figures, about half of them are disposed of within 12 months of trial. And it takes maybe up to a year to get to trial.

Chairman PICKLE. Well, can you say roughly that the case can be docketed and tried normally within a year's time?

Judge NIMS. Yes, that is correct, sir, within a year's time.

Chairman PICKLE. Is that a speedup from the previous schedule?

Judge NIMS. Yes. It is. We have a new so-called FIFO system of docketing cases, which is working very well in that respect.

Chairman PICKLE. My staff pointed out to me recently that they had noticed a clipping where a taxpayer smuggled a gun into Tax Court out in Seattle and shot himself.

Judge NIMS. Yes, sir.

Chairman PICKLE. Was that over some tax problem and he just couldn't face it, or can you supply any additional data on that event?

Judge NIMS. Well, he was representing himself before one of our judges. And he just, without any warning whatever, pulled a magnum .357, I believe it was, pistol out of his brief case and said something like I've given everything else I've got to the IRS, they might as well have my brains. And he put the thing in his mouth and shot himself, which was a pretty shocking event for all of us.

Chairman PICKLE. Well, the question I raise, of course, is one of security.

Is there any kind of security with respect to courtroom procedures that allows a man in a court with a gun?

Judge NIMS. Well, this really brought to our attention dramatically the ease with which a gun could come into one of our courtrooms. And so after that event, we immediately began to establish screening at our calendar calls. We have very much beefed up our security at our courthouse in Washington.

A few years ago, the Congress provided that the U.S. marshals would give us assistance on security, and we have been in the process of implementing that.

Chairman PICKLE. Well, do you have security devices for the entrance to the courtroom, or is it just an individual arrangement with the marshal to seek to have some security established?

Judge NIMS. Well, we have security in some of our courtrooms at the entrance to the courtroom. In places where we don't have a metal detector, the marshals use hand-held metal detecting devices.

Chairman PICKLE. Now, Mr. Shulze, do you have any questions for the judge?

Mr. SCHULZE. Mr. Chairman, I do not have any questions of the judge. His request is reasonable. They are doing a good job. They are heading in the right direction. I don't want to add any confusion to that.

Thank you.

Chairman PICKLE. Judge, we've heard stories that the Internal Revenue Service is running out of funding. There's a considerable number of stories that are appearing in the Washington Post about the lack of funds in various categories and that they couldn't afford such things as expert witness fees.

Are you aware of any instances where the IRS budget crunch has affected the court in any way, your court? For example, has Internal Revenue Service sought continuances in any cases because of its inability to get an expert witness?

Judge NIMS. No. I canvassed our judges on that subject, and none of them so far has seen any occurrence where a continuance had to be granted for that reason.

Chairman PICKLE. Well, we thank you. I, personally, am glad about the sharp reduction of this caseload, and I wish you well. Keep it up. We will be down to check with you further, but we're pleased to have your testimony.

Judge NIMS. Thank you very much.

Chairman PICKLE. Thank you, Judge.

Now the Chair would ask Jennie Stathis, representing the U.S. General Accounting Office, if she would please take her position at the witness table.

I believe we also have Mr. James R. Watts, the Associate Director of the Information Management and Technology Division, GAO.

So we have Jennie Stathis, the Director of the General Government Division, and Mr. James Watts both with us this morning again, and we're glad to have you here.

Now, Ms. Stathis, if you'll proceed with your statement.

STATEMENT OF JENNIE S. STATHIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DAVID J. ATTIANESE, ASSISTANT DIRECTOR, GENERAL GOVERNMENT DIVISION

Ms. STATHIS. We are pleased to be here this morning, Mr. Chairman, to participate in your hearing. I will attempt to summarize the testimony and avoid repeating things that have already been covered this morning.

We believe that a key issue with the IRS budget is how much money is really needed to adequately fund IRS current operations and changes necessitated by legislative mandates and increasing workloads.

With the IRS budgetary situation in fiscal year 1989 as a prologue, we question whether the administration has properly reflected what IRS will need to assure adequate funding of its ongoing activities in fiscal year 1990.

Given the probable shortfall in funds needed for current operations and the mandated increases, we question whether it is realistic to consider applying any new funds received to discretionary initiatives.

We have some information in our statement about the fiscal year 1989 shortfall, which is expected to be about $360 million. Some of the shortfall stems from such things as an unfunded pay raise and a postal rate increase, health insurance and retirement costs that were higher than had been anticipated, and some special salary rates.

IRS is no different from other agencies in having to deal with such unfunded costs, nor are these costs a new phenomenon. In the past, agencies were able to recover at least some of them through supplemental appropriations. But, as you may recall, the budget agreement between the administration and the Congress in November of 1987 stipulated that requests for supplemental appropriations should only be initiated in cases of dire emergencies.

So, as a result, when IRS submitted a request for supplemental funding, OMB denied it.

The shortfall was somewhat exacerbated in 1989 because of several new program initiatives. About $82 million of the shortfall was attributed to those initiatives with the major item being about $57 million to stabilize and upgrade the telephone assistance work force. There were about four or five other initiatives that had a much smaller effect on the shortfall.

Although these initiatives are important and, in many cases, respond to GAO recommendations as well as this subcommittee's, IRS' decision to fund in 1989 added to its budgetary problems.

In terms of the effect of the shortfall, IRS implemented a hiring freeze at the beginning of the year, and imposed restrictions on travel, training, equipment acquisitions, and the like.

As noted in my statement, those restrictions resulted in reduced supplies, deferments of equipment replacements, cancellation of plans to convert some staff from temporary to permanent positions, and the curtailment of some compliance efforts, such as a reduction in the number of correspondence audits in one of the service centers.

Not all of the cutbacks we noted have been caused by the shortfall. Some have resulted because attrition is not as high as IRS had anticipated and because staff are working more efficiently and making fewer errors. Thus IRS needs fewer staff.

It is unclear what specific steps that IRS will have to take to completely eliminate the budgetary shortfall this year, or what effect those actions will have on taxes collected. The situation may become clearer around the end of April when IRS is to complete its midyear financial plan.

As noted in our statements, managers, in preparing their financial plans, were told to maintain a lot of the essential operations. Based on our review of the documents and our discussions with IRS officials, we are not aware of any specific cutbacks at this time that would affect telephone assistance, the distribution of forms and publications, or the processing of tax returns. Those areas were specifically exempted from the cutbacks.

Moving to the 1990 budget, as has been discussed earlier, the budget does call for an increase of more than 2,000 positions and about $289 million, which is a net of increases for some workload growth and some new programs and decreases due to nonrecurring costs.

Although the budget calls for a net increase in funding, it may not be enough to maintain basic operations. The major reason is the absence of any allowance for additional costs to implement legislation enacted in 1988.

The program initiatives have been discussed quite a bit this morning so I will not go into the details other than to say that all of those initiatives are ones that the General Accounting Office generally supports. They are all in response to problems and changes that we see occurring that makes them all needed.

Because the budget does not include various costs, but also includes questionable savings, we believe it provides the framework for another shortfall in 1990. Most significantly, the budget does not cover the costs to implement three new pieces of legislation. Also, like 1989, the 1990 budget does not include sufficient funds for increased salaries, insurance premiums, and retirement benefits.

Finally, the 1990 budget includes savings that OMB expects IRS to obtain from A-76 reviews, savings that IRS believes are not unattainable.

Our statement also includes some information about the Tax Court. Since you have just heard from the chief judge there, I won't repeat that again.

In conclusion, although there have been cutbacks as a result of this year's budget shortfall, IRS is functioning so far without any significant disruption to its basic operations. We are uncertain, however, what lies in store for the rest of 1989 because IRS has not completed its midyear financial review.

Looking ahead, we question the adequacy of the 1990 budget because it does not provide for costs IRS will incur to implement new legislation and other increased personnel costs.

In a more general vein, Mr. Chairman, IRS' problems are a microcosm of what all Federal agencies are going through to one degree or another because of our inability to deal with the deficit. As GAO has said on many occasions, we believe the deficit and our inability to deal with it is the most serious domestic problem facing the country. It is not realistic to expect our agencies to continually absorb pay and benefit increases and not suffer adverse operational consequences. In fact, we believe that even more serious consequences could occur in the future if such a policy is continually pursued.

Not only will current operations suffer, but it will be virtually impossible to implement any new initiatives with adequate levels of funding. Until the deficit is dealt with effectively, we believe that Congress should examine very carefully proposed new initiatives to determine if there are adequate funds to begin them, while assuring that current needed operations are carried out effectively and efficiently.

That completes my summary. We will be pleased to answer your questions after Mr. Watts speaks.

[The statement of Ms. Stathis follows:]

STATEMENT OF JENNIE S. STATHIS, DIRECTOR
TAX POLICY AND ADMINISTRATION ISSUES
U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its inquiry into the Administration's fiscal year 1990 budget request for the Internal Revenue Service (IRS).

That request is for about $5.5 billion, an increase of about $289 million from fiscal year 1989. The request would fund about 115,000 average positions, an increase of about 2,050 from fiscal year 1989. Included in the increase is about $230 million for various new program initiatives.

A key issue appears to us to be unresolved--how much money is really needed to adequately fund IRS' current operations and changes necessitated by legislative mandates and increasing workloads? With IRS' budgetary situation in fiscal year 1989 as a prologue, we question whether the Administration has properly reflected what IRS will need to assure adequate funding of its ongoing activities in fiscal year 1990.

Given the probable shortfall in funds needed for current operations and mandated increases, we question whether it is realistic to consider applying any new funds received to discretionary initiatives.

FISCAL YEAR 1989 SHORTFALL

IRS has said it will experience a budgetary shortfall this year of about $360 million. Some of the shortfall stemmed from costs that could have been anticipated, but the Administration's budget procedures do not allow agencies to include these projected costs in their budget requests. For example, about a fourth of the shortfall ($85 million) was due to the 4.1 percent pay raise that became effective in January 1989. All federal agencies knew for months that they would have to absorb that raise and that there would probably not be supplemental appropriations to cover it. IRS' budget also did not reflect unanticipated costs due to such changes as a postal rate increase that became effective in April 1988 or sufficient increases for employee health insurance premiums and retirement benefits.

IRS is no different from other agencies in having to deal with such unfunded costs, nor are those costs a new phenomenon. In the past, agencies were able to recover at least some of these costs through supplemental appropriations. The November 1987 budget agreement between the Administration and the Congress, however, stipulated that requests for supplemental appropriations should only be initiated in cases of dire emergencies. Accordingly, when IRS submitted a request for supplemental funding in spite of this guidance, that request was denied by the Office of Management and Budget (OMB).

IRS exacerbated the shortfall by funding several new program initiatives during fiscal year 1989. According to IRS, about $82 million of the shortfall was due to initiatives that IRS decided to undertake in fiscal year 1989 even though it received no additional funds for those initiatives. Of that amount, IRS attributed $57 million to an initiative that was directed at improving the telephone assistance program by stabilizing and upgrading the work force responsible for answering taxpayers' telephone inquiries. Although that initiative is important and responds to GAO's and the Subcommittee's concerns about the quality of IRS' telephone assistance, IRS' decision to fund it and other initiatives in 1989 added to the budgetary problems in other parts of the agency.

Effect of the 1989 shortfall

To deal with this year's shortfall, IRS, at the beginning of the fiscal year, implemented a hiring freeze and imposed restrictions

on travel, training, equipment acquisitions, and the like. We discussed those actions with officials in IRS' National Office; its service centers in Andover, Massachusetts, and Fresno, California; its Compliance Center in Austin, Texas; and its District Office in Baltimore, Maryland. We also talked to representatives of the National Treasury Employees Union.

Those discussions indicated that the cutbacks and restrictions have led to reduced supplies; deferments of equipment replacements; cancellation of plans to convert some staff from temporary to permanent positions; and the curtailment of some compliance efforts, such as a reduction in the number of correspondence audits done at the Fresno Service Center. At the service centers, some seasonal employees were furloughed and some personnel were transferred from one function to another, but these changes may not all be due to the budget shortfall. Management at the Andover Service Center told us, for example, that 699 employees had been furloughed since January 1, 1989, primarily because (1) attrition was much lower than expected and (2) staff were more efficient and making fewer errors.

One effect of the shortfall that has apparently not happened to the extent anticipated has been a reduction in compliance staff through the hiring freeze. Examination, for example, originally expected to reduce its staffing by about 1,000 positions nationwide. As of March 30, however, Examination was expecting reductions of no more than 200 positions because attrition had been much lower than anticipated. An Examination official told us that because staffing levels were not going down as much as anticipated, the shortfall had to be made up in other ways. The one significant cutback he mentioned involved a reduction in the amount of funds that would be devoted to the Automated Examination System in 1989.
Because the hiring freeze has apparently not had its intended effect, it is unclear what specific steps IRS will take to completely eliminate the budgetary shortfall or what effect, if any, those actions will have on taxes collected. The situation may become clearer around the end of April when IRS managers in the National Office and in the field are to submit revised financial plans. In preparing their plans and deciding what steps to take to stay below allocated expenditure ceilings, the managers were told to (1) not cut back mandatory training or travel required to resolve specific tax cases; (2) ensure that returns are processed and remittances deposited on time; and (3) provide an 85 percent level of telephone service during the filing season, which is the level IRS strives to achieve every year.

Based on our review of IRS documents and our discussions with IRS personnel, we are not aware of any specific cut backs that would adversely affect IRS' ability to provide telephone assistance, distribute forms and publications, or process tax returns. In fact, when IRS notified its regions in October 1988 of the need to freeze the hiring of technical staff, it specifically exempted returns processing, forms distribution sites, and taxpayer assistance.

IRS' BUDGET REQUEST FOR FISCAL YEAR 1990

As noted earlier, the Administration's fiscal year 1990 budget request calls for an increase of 2,052 average positions and about $289 million over IRS' authorized levels for 1989. This increase is a net of (1) increased funds for current services, workload increases, and new program initiatives and (2) decreases because of nonrecurring costs, expected savings, and transfers to other organizations. Although the budget calls for a net increase in IRS' funding, it may not be enough to maintain basic operations. The major reason is the absence of any allowance in the budget for additional costs IRS expects to

incur in implementing legislation that was enacted toward the end of 1988.

Program initiatives

IRS' 1990 budget includes about $230 million to fund several new program initiatives. Each initiative has at least one of three primary objectives--collect additional tax revenue, improve responsiveness to taxpayers, or modernize ADP systems. We generally support the initiatives in the 1990 budget request. My colleague from GAO's Information Management and Technology Division will testify separately on the initiatives in the ADP area. As for the initiatives to improve responsiveness to taxpayers, we have testified before this Subcommittee several times about quality problems in the telephone assistance program and in IRS' correspondence with taxpayers. The 1990 budget request includes funds to improve both aspects of communication with taxpayers.

We also support initiatives to collect more taxes owed the government. Our support is founded on a concern over the low level of audit coverage (just over 1 percent in fiscal year 1988), the increasing level of accounts receivable (about $65 billion as of the end of February 1989), and the size of the overall tax gap (estimated to be $87.1 billion in 1988). The five revenue initiatives in this year's budget are intended to allow IRS to (1) dispose of 47,000 more delinquent accounts, (2) resolve single issues on 188,000 more tax returns through service center contacts with the taxpayers, (3) work 332,000 more revenue-producing cases in the Combined Annual Wage Reporting Program under which IRS reconciles information reported to the Social Security Administration on annual wage documents and information reported to IRS on employment tax returns, (4) improve overseas tax compliance, and (5) monitor the use of social security numbers to claim exemptions for dependents. IRS estimates that these five initiatives will generate $318 million in additional taxes, penalties, and interest in fiscal year 1990.

As we have reported to you in prior years, neither we nor IRS know whether specific revenue initiatives are the most efficient and effective use of additional enforcement resources. In addition, we have not reviewed the specific revenue estimates associated with these 1990 initiatives and thus cannot comment on their reliability. The estimates, however, should be balanced against any revenues that might be lost as a result of reduced enforcement staff that may result from this year's shortfall or that may materialize next year.

Prospects for a shortfall
in fiscal year 1990

The Administration's fiscal year 1990 budget request for IRS does not include various costs and includes questionable savings, thus providing the framework for another shortfall next year. Most significantly the 1990 budget request does not include funding to cover the substantial costs that IRS expects to incur in implementing three new pieces of legislation. Like 1989, the 1990 budget does not include sufficient funds for increased salaries, insurance premiums, and retirement benefits. Finally, the budget includes savings that OMB has determined IRS can achieve through efficiencies associated with assessing the possibility of contracting out certain jobs under OMB Circular A-76--savings that IRS claims are unattainable.

Unfunded costs to implement new legislation

The Administration's budget for fiscal year 1990 does not include funds to cover any additional costs IRS might incur in implementing the Technical and Miscellaneous Revenue Act of 1988, the Anti-Drug Abuse Act of 1988, and the Medicare Catastrophic Coverage Act. As of the end of March 1989, IRS had not finalized its estimates of additional operating costs associated with the three new laws. It had developed preliminary figures, however, which indicated that a total of about 1,800 additional positions and $150 million would be needed to implement the three laws. Absent supplemental funding, IRS will have to absorb these costs.

Of the three acts, the Technical and Miscellaneous Revenue Act of 1988 affects IRS the most. Of the many provisions in that act, the ones cumulatively known as the Taxpayer Bill of Rights will have the most effect on IRS. Among other things, those provisions require IRS to inform taxpayers of their rights, provide for administrative relief in certain situations, and allow taxpayers to tape record in-person interviews. In its preliminary assessment of the impact of the Bill of Rights, IRS believes that substantial staff and/or dollars will be needed to do such things as (1) revise and distribute more than 300 forms and publications, (2) insure the validity of written responses to taxpayers' requests for advice, (3) improve the content of tax due and deficiency notices, (4) issue Taxpayer Assistance Orders, and (5) write regulations regarding the award of costs and fees in administrative and court proceedings.

The Anti-Drug Abuse Act of 1988 was passed to prevent the manufacturing, distribution, and use of illegal drugs. According to IRS, its workload, especially in the criminal investigations area, will be increased by the act's provisions relating to international narcotics control, drug trafficking, money laundering, and the requirement that certain businesses file Currency Transaction Reports.

According to IRS, the Medicare Catastrophic Coverage Act requires IRS to collect a supplemental premium from those covered by Medicare. To do that, IRS says it will need to process additional tax forms, rent and install ADP equipment, and respond to more taxpayer service contacts in fiscal year 1990.

Unfunded personnel costs

According to IRS, several of the unfunded personnel costs that contributed to this year's shortfall will also contribute to a shortfall in 1990. IRS' estimates of unfunded costs associated with the 1990 budget include (1) about $32 million related to the 4.1 percent federal pay raise that took effect in January 1989, (2) about $40 million related to the proposed 2 percent raise should it take effect in January 1990, and (3) about $48 million related to increased insurance premiums and retirement benefits.

Projected savings from OMB Circular A-76

Among the various reductions in the Administration's 1990 budget for IRS is one for $13 million that OMB has determined IRS can save through the efficiencies associated with studying, competing for, and possibly contracting out certain jobs as required by OMB Circular A-76. IRS officials we talked to felt that the number of positions subject to study under that Circular are much less than the number OMB believes should be studied. IRS officials felt also that there is little, if any, potential for savings in this area. The Treasury Department has little historical experience with contracting out, and the potential for IRS to save this amount through A-76 reviews is unknown. We have

suggested that OMB revise its A-76 approach to allow agencies more latitude in deciding how to achieve efficiency goals rather than imposing such rigid requirements.

TAX COURT'S BUDGET FOR FISCAL YEAR 1990

You also asked for our comments on the U.S. Tax Court's budget for fiscal year 1990. That budget totals $28.1 million, the same amount appropriated in fiscal year 1989 if you do not count the $1.2 million included in the 1989 appropriation for a new chiller/air conditioning system in the Court's Headquarters Building. Funds for the chiller/air conditioning system have been obligated and Tax Court officials expect it to be on line within 2 years. For fiscal year 1990, the Tax Court expects to absorb the costs associated with inflation and its budget includes no request for additional staff.

During the last 2 fiscal years, the Tax Court has made significant progress in reducing its case inventory. During fiscal year 1988, the number of cases filed with the Court declined 23 percent from the prior year and the number of cases closed increased 5 percent over fiscal year 1987. Altogether, the Court's inventory fell 17 percent during fiscal year 1988, from 81,549 cases at the end of fiscal year 1987 to 67,491 cases pending as of September 30, 1988. The Court expects the number of petitions filed in fiscal year 1989 to be at or below the fiscal year 1988 level of about 33,000 cases. The Court also expects to see a further reduction in its inventory during fiscal year 1989.

Although the Court's inventory of cases has been declining, it is unclear whether this trend will continue in future years. Certain factors, such as the partnership provisions in the Tax Equity and Fiscal Responsibility Act of 1982, which eliminated the need for investors to litigate separately, and IRS' settlement policy, which encourages the resolution of cases before a taxpayer petitions the Tax Court, have helped to reduce the inventory. Other factors, however, such as provisions in the Taxpayer Bill of Rights, which expanded the Court's jurisdiction, could cause the inventory to increase.

CONCLUSION

In conclusion, Mr. Chairman, although there have been cutbacks as a result of this year' budget shortfall, IRS is functioning so far without any significant disruption to its basic operations. We are uncertain, however, what lies in store for the rest of 1989 because IRS has not completed its mid-year financial review. Looking ahead, we question the adequacy of IRS' budget for 1990 because it does not provide for costs IRS will incur to implement new legislation and other increased personnel costs.

IRS' problems during fiscal year 1989 are a microcosm of what all federal agencies are going through to one degree or another because of our inability to effectively deal with the budget deficit. As we have said on countless occasions, we believe the deficit and our inability to effectively deal with it is the most serious domestic problem facing the country.

It is not realistic to expect agencies to continually absorb pay and benefit increases and not suffer adverse operational consequences. In fact, we believe even more serious consequences could occur in the future if such a policy is continually pursued. Not only will current operations suffer but it will be virtually impossible to implement any new initiatives with adequate levels of funding. The likelihood of any change in that policy is slim, however, unless Congress and the Administration effectively deal with the budget deficit.

Until the deficit is dealt with effectively, we believe Congress should examine very carefully any proposed initiatives to determine if there are adequate funds to begin them while assuring that current, needed operations are carried out effectively and efficiently.

That concludes my statement. We are prepared to answer any questions.

Chairman PICKLE. Mr. Watts, do you wish to add anything to that at this point? Do you have any statement to make?

Mr. WATTS. Yes, I do, sir.

Chairman PICKLE. All right. Will you proceed?

STATEMENT OF JAMES R. WATTS, ASSOCIATE DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. WATTS. We are pleased to be here to assist the committee in its inquiry into the 1990 budget request of IRS. And with me, on my right today, is Tim Bowling, Deputy Associate Director, and on his right is Mary Ellen Chervenic, Assistant Director.

My statement will focus on the information technology aspects of the budget. In brief, we found that the ADP portion of the request, about $933 million, appropriately focuses its resources on two critical efforts: maintaining existing computer systems and pursuing the Tax System Modernization Program. However, we have noted two areas that have budgetary implications for 1990 and beyond.

First, we are concerned that over the last few years IRS has not consistently identified the individual projects that make up the Tax System Modernization Program. This has made determining the budgeted and actual costs of the program very difficult, and its progress hard to measure. We believe that IRS should clearly and consistently identify these projects from year to year. This would enhance congressional and executive branch oversight of this very critical program.

Second, a major project, the automated examination system has been plagued by escalating costs, schedule delays, and elusive benefits. Although the 1990 budget request for AES has been cut from $110 million to $19.5 million, we believe IRS needs to make a number of improvements to the management of this project before committing additional money to it in the future.

Chairman PICKLE. What do you mean by committing funds to the management of the program?

Mr. WATTS. The intention of IRS that Mr. Wedick referred to earlier is to reassess the program, and come in with requests for additional moneys in the 1991 and 1992 budget for AES.

What we are saying is, we do not believe that those increases should be approved until they actually improve the management of the program, get a better handle on the actual cost of this program. The benefits to be derived from it, and how it will be integrated?

Chairman PICKLE. Why is it difficult now and why haven't we had those costs in hand? We've known this crunch was coming upon us for the last 5 to 10 years. Why would there be a lack of estimates of costs at this point?

Mr. WATTS. For the Tax System Modernization Program?

Chairman PICKLE. Yes.

Mr. WATTS. Well, at this point in time, they really have not decided upon a particular design. What they have is a general description of a design. They are looking at about 5 to 10 different alternative designs. And not until they actually cost benefit those designs and determine their feasibility will they really know what

the total cost of the Tax System Modernization Program will likely be.

They are doing that now. IRS intends to get that done in the late part of this calendar year, around the September to December timeframe. It's at that time that IRS should be able to tell us what the total cost of this program is going to be, and also give us a better idea of how long it is going to take. Is it really going to take 10 years or not? And that's part of the process that they are going through.

To that extent, we think the process they're going through is right. It's the decisions that we want to see coming out of that process at the end of this calendar year that are going to be critical, critical for all of us to really get a better handle on how much it is going to cost and how long it will really in fact take.

Let me talk first about the budget request for the modernization program. The total estimated cost for this program is hard to track and has been underestimated in past years, because the projects that comprise the program had been renamed, consolidated, split, and not always clearly identified in budget documents.

The 1990 budget request, for example, includes about $235 million for 17 projects, identified as part of the modernization program. In contrast, the 1989 request of $92 million included only five projects. The current 17 include 4 of the previous 5, and 11 that already existed in 1989.

Now, if IRS had included those 11 projects in the 1989 request, then the estimate for modernization would have been about $175 million rather than the $92 million that they reported in the budget.

So, what we have here is inconsistency in the reporting of exactly how much is really part of the modernization program.

In our view, in order for the Congress to provide adequate oversight of this essential and costly program, IRS should clearly identify and consistently identify the projects from year to year that make up the modernization effort. This would include a concise comparison of past and current funding requests and expenditures, as well as dates by which the projects should be completed. This should facilitate Congress' ability to monitor the progress of the program and its cost, and it would be helpful to Treasury and OMB in this budget approval process.

Let me now turn to the automated examination system. The development of this system presents a relatively bleak picture. As originally conceived in 1982, AES was to automate the examination of tax returns in IRS' Service Centers and in its district and local offices at a cost of about $77 million. The project was significantly expanded in 1984 to provide additional features, including 18,000 laptop computers and software for field agents. The expanded system was to be complete by 1989 at a cost of $1 billion.

After the expansion, however, cost estimates have risen by another $800 million, the schedule has slipped by 6 years, and IRS has been unable to conclusively demonstrate the benefits from the one portion of the system that is in fact operational.

The program has encountered several software development problems. For example, the first operational software produced under AES was intended to increase productivity by automating

the examination of Form 1040 returns on the 18,000 laptop computers. Unfortunately, the first version of this software was delivered to revenue agents in 1986 and was extremely cumbersome to use. A May 1988 study found that 77 percent of the revenue agents were dissatisfied with the software, and only about one-third of the agents used it.

IRS had to revise the software and is now fielding a version that performs the same functions that is somewhat less cumbersome. This software is now being rewritten in a different programming langauge. Although IRS approved one language for the contractor to use, it reversed its position later after the software had been written.

IRS is now rewriting the software in an IRS standard programming language and has completed only about one-third of it. AES benefits also have proven to be questionable. For example, early estimates assume that AES will produce about $40 billion in increased tax revenues. Six months later, this was reduced to about $14 billion when a significant error was discovered in the method that was used to calculate these benefits.

Furthermore, because IRS has been unable to verify that the laptops have actually resulted in increased tax revenues, IRS is devising a new method that identifies benefits on the basis of potential staff year reductions.

The issue of integration is also yet to be resolved. By integrating systems, such as AES with the Tax System Modernization Program, IRS hopes to allow users of different systems to exchange taxpayer data and information and update taxpayer accounts on the master files. However, in order to exchange this information, the data elements on all systems must be consistent. IRS has not yet resolved how it will make the data structures in AES consistent with the data structures in other systems that are part of the modernization effort. Unless issues such as these are resolved, AES will not be able to automatically exchange data with the other systems.

By implementing this system before determining how it will be integrated with the tax system modernization, IRS runs the risk of having to make potentially difficult and costly system modifications and retrofits.

Faced with the need to cut costs, OMB reduced the 1990 budget request for AES from $110 million to $19.5 million. Treasury officials agreed to this reduction, noting that the project was badly managed and lacked clear direction. IRS intends to restructure the program and seek additional funding in future years.

We believe the budget reductions are appropriate, given the system development problems, the lack of tangible benefits, and the unresolved integration issues. Before additional investments are made in the current project, IRS should resolve the development problems, demonstrate the benefits, and set out a plan for integration with the modernization program.

This concludes a summary of my statement, and I will be happy to answer questions.

[The statement of Mr. Watts follows:]

Statement of
James R. Watts, Associate Director
Information Management and Technology
Division

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the subcommittee in its inquiry into IRS' budget for fiscal year 1990. My statement will focus on the information technology aspects of this budget. In brief, we found that IRS' 1990 ADP budget request of about $933 million appropriately focuses resources on two critical efforts: maintaining existing computer systems and pursuing IRS' long-range plan for automation, currently known as Tax System Modernization. However, we have noted two areas that have budgetary implications for 1990 and beyond:

-- Over the last few years, IRS has not consistently identified the individual projects that constitute Tax System Modernization. Projects have been merged, split, renamed, added, or deleted. This has made determining the budgeted and actual cost of modernization very difficult and its progress hard to measure. We believe IRS should clearly and consistently identify Tax System Modernization projects from year to year. This would keep the Congress, Treasury, and OMB better informed on the scope, progress, and cost of the Tax System Modernization program.

-- The Automated Examination System (AES) has been plagued by escalating costs, schedule delays, and elusive benefits. Recognizing these problems, OMB and Treasury have reduced IRS' 1990 budget request for AES from about $110 million to $19.5 million. Under the circumstances, the Subcommittee may wish to obtain from IRS information on what tangible or intangible benefits are expected before spending these funds. In addition, before committing any additional money to this system in the future, IRS needs to clearly demonstrate its benefits, resolve its development problems, and plan for its eventual integration into the Tax System Modernization effort.

My testimony is based on work that is still in process. As a result, these observations are preliminary.

IRS' INFORMATION TECHNOLOGY BUDGET REQUEST

During the past few years, it has been difficult to determine the total funding for IRS' Tax System Modernization effort. Because projects have been renamed, consolidated, spiit, and not always clearly identified in budget documents, the total estimated cost for Tax System Modernization is hard to track and has been understated in past years.

The 1990 budget request, for example, includes about $235 million for 17 projects identified as part of Tax System Modernization. In contrast, the fiscal year 1989 budget request of about $92 million for Tax System Modernization included only five projects. The current 17 projects include 4 of the previous 5 projects, all or parts of 11 existing projects not previously considered part of Tax System Modernization, and five new projects. If IRS had cited these projects as part of Tax System Modernization in the fiscal year 1989 budget, the amount for Tax System Modernization would have been about $175 million, or almost twice the total amount reported for the program last year.

In addition to the 17 projects designated as part of Tax System Modernization, there are still other projects which IRS considers to be part of the modernization program, yet are not identified as such in the 1990 budget. For example, the 1990 budget request for two projects--the Automated Underreporter Program and the Automated Examination System--amounts to over $29 million. Both of these projects were listed as part of Tax System Modernization in the 1988 IRS Management Plan. In addition, the Acting Commissioner of IRS stated before this subcommittee on March 16, 1989, that the Automated Underreporter Program was one of three examples of a Tax System Modernization project well underway.

Yet, neither the Underreporter Program nor the AES are cited as modernization projects in IRS' proposed budget for 1990.

In order for the Congress to provide adequate oversight of this essential and costly program, IRS should clearly and consistently identify in its yearly budget requests all projects that comprise the modernization program. In addition, a concise comparison of past and present funding requests and expenditures by project, including information on funds reprogrammed among projects, should facilitate the Congress' ability to monitor the progress and cost of this program. This information would also be useful to Treasury and OMB in the budget approval process.

AUTOMATED EXAMINATION SYSTEM
BUDGET CUTS ARE APPROPRIATE

The development of IRS' Automated Examination System presents a bleak picture. As originally conceived in 1982, AES was to automate the examination of tax returns in IRS' Service Centers and district and local offices, at a cost of about $77 million. The project was significantly expanded in 1984 to provide additional features, including 18,000 laptop computers and software for field agents. The expanded system was to be completed by 1989 at a cost of $1 billion.

Since expansion, cost estimates have risen by $800 million, the schedule has slipped by 6 years, and IRS has been unable to conclusively demonstrate benefits from the one portion of the system that is operational. In addition, AES is being developed without adequate planning for its intended integration into IRS' long-range Tax System Modernization effort. Achieving integration after AES has already been developed could involve difficult and costly system modifications.

Many of the difficulties AES has experienced have been due to software development problems. For example, the first operational software produced under AES was intended to increase productivity by automating the examination of Form 1040 returns on the 18,000 laptop computers. Unfortunately, the first version of this software that was delivered to revenue agents in July 1986 was extremely cumbersome to use. A study by a private contractor in May 1988 found that 77 percent of revenue agents were dissatisfied with this software, and only one-third used it. Another study quoted AES managers as expressing serious doubts that it could ever save the agents time in performing their work. IRS had to revise the software and has now fielded a version that performs the same functions but is less cumbersome.[1]

This software is now being rewritten in a different programming language. Although the Office of Computer Services originally approved the language the contractor used in writing the laptop software, after the software had been written Computer Services reversed its position because it did not intend to maintain personnel skilled in the original language used for the laptops' software. The AES project office is currently rewriting the laptop software in an IRS standard programming language and has completed about one-third of it.

AES benefit estimates have proven to be questionable. For example, benefit estimates in January 1987 assumed that AES would produce about $43 billion in increased tax revenues over the life of the system. Six months later, this estimate was reduced to about $14 billion when IRS' Examination Planning Office made a significant correction in the method the AES project office used to estimate benefits. Furthermore, the basic assumption underlying this revised estimate is questionable because IRS has been unable to verify that the use of laptop computers has

[1]The first version of the software required agents to switch back and forth among 18 different disks to run the system. This software was revised and now uses seven disks.

actually resulted in the examination of additional tax returns or increased tax revenues. IRS has abandoned its original approach of basing project benefits on increased tax revenues and is devising a new system for determining benefits on the basis of potential staff-year reductions.

The issue of integration is unresolved. By integrating systems such as AES with other Tax System Modernization initiatives, IRS hopes to allow users on different systems to exchange taxpayer information and update taxpayer accounts in its master files. However, in order for this data exchange to work, the data elements in all systems must be consistent. For example, data elements such as a person's name must have the same structure in every system. In other words, John Peter Smith's name must appear as "John Peter Smith" in every system. If it appears as "Smith, John P." or "J.P. Smith" in different systems, the data on this taxpayer could not be automatically exchanged.

Because AES has been allowed to progress ahead of Tax System Modernization, it has developed its own structures for the data it uses. IRS has not yet addressed how it will make AES data structures consistent with data structures of other systems that are part of the modernization effort. Additional data exchange issues include determining how data will be distributed among the different systems and how it will be kept current. Unless issues such as these are resolved, AES will not be able to automatically exchange data with other systems.

IRS decided to develop AES independently and to incorporate it into Tax System Modernization later because it was believed that AES provided important immediate benefits and should not be postponed. By implementing AES before determining how it will be integrated into Tax System Modernization, however, IRS risks having to make potentially difficult and costly system modifications.

Faced with the need to cut costs, the Office of Management and Budget reduced AES' 1990 budget request by 82 percent, from about $110 million to $19.5 million. Treasury officials agreed that the project's funding should be reduced, noting that the AES project was badly managed and lacked clear direction. IRS intends to restructure the program and seek increased funding in future years.

We believe the budget reductions to the AES project are appropriate, given the system development problems, the lack of tangible benefits, and the unresolved integration issues. Before additional investments are made in the current AES project, IRS should resolve AES' development problems, demonstrate its benefits, and plan for integration with Tax System Modernization.

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Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions at this time.

Chairman PICKLE. Well, Mr. Watts, let me start off by asking, do you think the Internal Revenue Service will be able to adjust to the challenges they have ahead? You have indicated they have had some difficulty in administering the equipment programs, the testing hasn't been adequate, and the funding had been cut.

Now, they have ahead of them the overall problem of putting in place a new system. Will the Internal Revenue Service be able to meet that schedule?

Mr. WATTS. Well, first of all, as I've said, in some past statements, in order for them to do this, they need to change their thinking about the kind of people they have in the organization. They need to bring in people who have a greater technical expertise to make the kind of decisions on where they ought to go with this technology. Not until they do that are they going to be able to pull off the modernization effort successfully.

Chairman PICKLE. Then why haven't they done it in your opinion?

Mr. WATTS. Well, I think there's a culture in IRS that says we can do it from within. Over the years the Executive Development Program has been used to bring people up through the organization.

I think another part of the problem that contributes to it is that it's very difficult for them to use their inhouse people to develop these new systems, because their inhouse people are only knowledgeable and skilled in the old technology. That's what their current systems are. So they have to make a cultural change. They have to make a change in management perspective on the kind of people to bring into the organization to handle this.

Chairman PICKLE. Well, now, from 1985, we have generally just patched up the operational functions of the front-end processors. One phase of that did break down and we patched that up, and corrected it. We have fought hard the last 3 years just to catch up and now to stay ahead. And, the Lord be praised, we have avoided another 1985 fiasco since then.

All the time we knew, though, that it was going to hold place only so long, 1990, 1992, or 1993 probably at best. Is that an accurate analysis or do you know?

Mr. WATTS. Well, the front-end processors should probably be able to go beyond that. However, it's the systems they tie to—the mainframes—that we believe will have capacity problems in the 1992 to 1994 timeframe.

Chairman PICKLE. Do you think that the lack of planning has been because they just didn't bring on anybody from the outside, or is it funding problems? Have they just been apprehensive about asking for this money? What has caused the delay because we've known now for 5 or 6 years that this was ahead of us?

Mr. WATTS. Sure. I don't believe it has anything to do with funding problems at all. I'm not aware of them not being given the money that they need or the money that they've asked for as far as any modernization programs are concerned.

Chairman PICKLE. Then, you think it's primarily a matter of just changing their approach, you say?

Mr. WATTS. Yes, sir. And bringing the people onboard to make that approach happen.

Chairman PICKLE. Now, Ms. Stathis, do you agree with that or do you have any other view of it?

Ms. STATHIS. I think I agree with that.

Our reviews of the budget over the years have shown that IRS has received sufficient funds to proceed with the design of this program.

Chairman PICKLE. Well, I want to say to you, GAO, we've asked that you look into the data processing and computerization system modernization of the Internal Revenue Service. But we're going to depend on you to give us a good current running analysis and to bother Internal Revenue Service. Today you have indicated that the schedule has been agreed upon. I don't think we've got 10 years to let it go into place. I think it's going to be much sooner than that. There's going to be a lot of accountability on this subject if the agreement isn't lived up to and if we don't address this problem immediately.

Now, I'm going to yield to Mr. Schulze, but first let me ask you. Earlier we asked the Commissioner if the IRS had any drug problem within some of the service centers, and he indicated yes somewhat. In Austin, TX, we had apprehended four or five of the individuals, and they resigned.

We had asked the GAO to look into that question to see if this type of problem is in existence with other service centers? The GAO told us that they would look into that also. GAO promised to do that.

Three weeks later, the GAO called our office and said it wouldn't be able to look into that drug question unless we send something in writing.

Are you familiar with that development?

Ms. STATHIS. I'm not, but maybe Mr. Attianese is.

Chairman PICKLE. Mr. Attianese, can you comment on that?

Mr. ATTIANESE. I am not aware of that kind of dialog going on. I know that we were asked, when we visited the service centers, to keep our eyes open and see if we saw anything going on down there.

We did make some inquiries in Austin, but they didn't want to talk to us because there were ongoing investigations. But it was impossible for our people to make any judgments as to whether there was anything——

Chairman PICKLE. I am going to have the staff furnish me the colloquy that we had with your office asking you to check into some of these other service centers.

Mr. ATTIANESE. We did go to the service centers, Mr. Pickle.

Chairman PICKLE. I'm asking about just service centers.

Mr. ATTIANESE. Right. We went to Andover, we went to Fresno, and we went to the Austin Compliance Center to look at the effects of the shortfall.

We were asked when we went down to those service centers to keep our eyes open as to whether we could see if there was any problem with drugs. We were only in the service centers for a couple of days. There wasn't anything we could do while we were there to get any idea as to the incidence of drug abuse at the service centers.

Chairman PICKLE. I'm not trying to have you explain why it would be difficult. I made the request, as chairman of the committee, and I asked that you look into these other nine service centers to see if they had any kind of a similar problem with drugs within the agency itself. And you agreed to do that.

Then you came back to my office 3 weeks later and said you don't have that request in writing and you can't proceed unless you have it in writing.

Is that correct?

Mr. ATTIANESE. I'm not aware of that.

Chairman PICKLE. That's totally unacceptable. If you needed something in writing, you should have told us at that time. Three weeks later you tell me.

Mr. ATTIANESE. We never asked that anything be put in writing, Mr. Chairman.

Chairman PICKLE. Well, I submit to you that I think someone did, and we'll try to find out who that was.

I just say that that's a breakdown in administration. We don't have to have that kind of technical fallback about your inability to pursue the request of a committee.

Ms. STATHIS. Mr. Chairman, let me apologize if that happened or if there was any sense that that happened. That certainly should not have occurred. Occasionally we have access problems with IRS, unless we have something in writing as to what we are doing. I'm not aware that even that happened in this case. But let me pursue this, and I will get back to you on it because it should not have happened.

Chairman PICKLE. All right. Well, we'll talk with you further about that. I just want to be sure that there's not any attempt by you to fall back on a technicality.

Ms. STATHIS. We did ask questions.

Chairman PICKLE. We need the information.

Ms. STATHIS. We did ask questions when we were in the service centers on this.

Chairman PICKLE. Overall, I take that your testimony and Mr. Watts generally is that Internal Revenue Service today is not facing a crisis. Although they have had to absorb over $350 million of other costs, such as the drug bill and the Technical and Miscellaneous Revenue Act, they have been able to function. They're not in dire circumstances for paper or pencils or other fundamental equipment. They're able to handle the job at this point.

But, you are concerned about what happens in the future unless they immediately get some additional funds and start planning properly.

So your concern is for the lack of planning or the funding for the program from this point on?

Ms. STATHIS. That's correct. We think that there is the potential for a shortfall in 1990 as well as 1989.

Chairman PICKLE. Well, when you say a potential for a shortfall, you mean the danger of a breakdown in the system?

Ms. STATHIS. Well, there won't be enough money to fund the same level of activity that you have been expecting of the IRS over the past several years. Something will have to be foregone.

Chairman PICKLE. I see. Well, I agree with you.

Mr. Schulze, do you have any questions of the GAO?

Mr. SCHULZE. Yes, Mr. Chairman.

Thank you, and I thank you for your testimony. And my question follows the line that I asked Acting Commissioner Murphy about the automated examination system, and I would like to have your response to his statements.

Mr. WATTS. Mr. Murphy's response to the automated examination system?

I believe that Mr. Wedick basically agreed with what we said. I think his concern basically was we thought it maybe too bleak. I guess that's in the eyes of the beholder. I think it is a fairly bleak situation.

Mr. SCHULZE. You stated and I don't have it exactly, that the schedule has slipped by 6 years.

Mr. WATTS. Yes, sir.

Mr. SCHULZE. You are in effect saying we're doing it. We ran into some problems, so we're deliberately slipping the schedule. Is that just a difference in semantics or do you agree that that——

Mr. WATTS. The schedule was being slipped because they were encountering problems. And the problems they were encountering were difficulties with developing the software. They had problems in having poor definition of user requirements, and they tried to develop software from that. And then they had to go back and redo the software.

It was those kinds of things.

Mr. SCHULZE. Mr. Watts, in your opinion, should the program be scrapped, or is it salvageable? And if it's salvaged, will it be of great benefit?

Mr. WATTS. I think in concept that the system is worthwhile. I think, though, that IRS was overly optimistic, overconfident, didn't realize the complexity, the size of the task before them, and had problems.

I think they need to do something in this area. I think there are productivity improvements that are possible if the system is designed right, and is designed basically with the user in mind.

So I would endorse having that kind of a system, but I do believe that a very hard look needs to be taken at what they have today. Because I'm not sure whether they should take the design they have now and move forward with it.

Mr. SCHULZE. As a layman, I would assume that the technology that we presently have would make that system possible, is that correct?

Mr. WATTS. Absolutely. No question.

Mr. SCHULZE. So it's not some esoteric proposal that——

Mr. WATTS. They're not trying to do something that's impossible.

Mr. SCHULZE. Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. We thank you for your testimony. We will have additional questions to submit to you, and we'll ask you to respond to us in writing as quick as you can.

Thank you very much.

[Questions submitted to GAO and their responses follow:]

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April 25, 1989

The Honorable Charles A. Bowsher
Comptroller General of the United States
United States General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

I want to thank Ms. Jennie S. Stathis and Mr. Jim Watts of the United States General Accounting Office for testifying at the Subcommittee on Oversight's hearing on the Administration's FY 1990 budget proposals relating to the Internal Revenue Service and the U.S. Tax Court. To complete our hearing record, I would appreciate having GAO's responses to the following questions by the close of business, Monday, May 22, 1989.

I. OVERVIEW

1. Would GAO support an increase in funding, for certain accounts, over the FY 1990 Administration budget request? If so, for which accounts and why?

2. The Administration's FY 1990 budget proposal did not include funds for implementation of the drug bill, the medicare catastrophic health care bill, and the technical corrections bill, which includes the taxpayer bill of rights. GAO has indicated that although the proposed IRS FY 1990 budget increases over FY 1989 funding, it may not be enough to maintain basic operations because of the additional costs of implementing this legislation. What types of problems could result in FY 1990? Which of IRS's basic operations stand a potential to decrease in FY 1990 below its current level?

3. At the request of the Subcommittee, GAO has visited certain IRS service centers to determine the impact of the FY 1989 funding shortages on IRS operations.

   (a) GAO testified that the funding shortfall in FY 1989 resulted in the deferment of equipment replacements, cancellation of plans to convert some

staff from temporary to permanent positions, and curtailment of some compliance efforts. Would GAO provide specific details on each of these cutbacks and evaluate the impact?

(b) If there are no big problems thus far in 1989, are there areas which should be monitored throughout 1989 because a potential for difficulties exists?

(c) Are employees being furloughed? If so, why and from which activities?

(d) Please provide GAO's analysis of IRS's mid-year financial review, as soon as possible, for the record.

II. EXAMINATION AND APPEALS:

1. The Administration has included a new revenue initiative in their FY 1990 budget proposal which combines various examination activities including correspondence audits, closing unpaid tax accounts, and reconciliation of wage reports between IRS and the Social Security Administration.

   (a) Does GAO support this initiative?

   (b) What concerns are raised by the components of this initiative, such as the use of correspondence audits when GAO has raised serious questions generally about the quality of IRS's handling of taxpayer correspondence?

2. Is it possible for the IRS to increase the audit rate in FY 1990 with fewer positions in examination?

3. In the past, GAO has noted that there is substantial lag time between the hiring of examination agents and the point at which IRS collects additional revenues.

   (a) Has the hiring freeze in examination this year, and therefore the inability to fill staff attrition, resulted in the strong possibility that the IRS will not be able to meet revenue targets in FY 1990?

   (b) Based upon GAO's review of current IRS operations, is there any reason to believe that the IRS will not meet revenue targets for FY 1989?

4. GAO has researched various exempt organization issues for this Subcommittee over the past few years. Is GAO aware of any reason why the IRS audit rate for exempt organizations in FY 1989 is now estimated at 2.5%, rather than the 4.67% noted in the FY 1989 budget?

III. INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

1. How will the IRS's new responsibilities under the drug bill impact tax fraud investigation programs in FY 1990?

2. Based upon GAO's findings, what is the impact of FY 1989 funding levels on the Criminal Investigation Division, including programs and equipment?

3. GAO reported at our hearing on the 1989 filing season that the taxpayer telephone assistance error rate was 34%, while IRS reported 37.6% incorrect. Since that time, GAO has continued to monitor IRS's test call system.

   (a) What is the current telephone accuracy rate based upon GAO's monitoring?

   (b) How will the FY 1990 budget proposal improve the accuracy rate?

   (c) Are there programs and/or funding which GAO would recommend for addition to the budget in order to improve the accuracy rate?

4. The number of taxpayers assisted in FY 1989 is now estimated at 33 million which is far below the 44 million estimated in the 1989 budget. What is the reason for the decrease? Has GAO found the availability of taxpayer service to be a problem this filing season?

IV. RETURNS PROCESSING

1. What is in the Administration's FY 1990 budget proposal to improve quality in those activities GAO has expressed concern about in the past: returns processing, error resolution, and adjustments and correspondence? Will the IRS be able improve training and/or reduce high turnover rates in these areas?

2. Will increasing the Returns Processing staffing by 1,000 positions accommodate the increased FY 1990 workload?

V. TAX SYSTEM MODERNIZATION AND COMPUTER RESOURCES

1. In addition to the Automated Examination System, is GAO aware of other major automation initiatives that are currently experiencing significant technical difficulties leading to either higher costs, delays in implementation, or both?

2. Since at least 1978 the IRS has been attempting to formulate a long-range plan to modernize its aged computer systems. Why has it taken this long to reach an agreement on such a plan? In GAO's judgement, does the Service now have the necessary management information on which to base the critical decisions it must make as part of Tax System Modernization?

3. GAO also has been critical of the Service's planning and testing efforts in those computer modernization projects which have already been undertaken. In GAO's judgement, what presents the greater risk to the taxpayer and the Service: that the Service delays implementation of Tax System Modernization until it is more fully defined thereby increasing the risk that the new systems will not be in place in time to meet the coming computer capacity shortfall; or, that the Service begin acquiring new systems immediately, and risk making false starts that could later prove to be costly and time-consuming to correct?

4. Does the IRS have a system in place to track the costs and progress of its major automation initiatives? Who is responsible for gathering this information, and to whom is it reported? Has the GAO requested this information, and has the Service honored this request?

5. Is GAO aware of any problems with the capacity and timeliness of responses in the Distributed Input System at IRS service centers? If so, please describe the problems and evaluate steps being taken to correct them.

As always, I appreciate your assistance with this matter.

Sincerely,

J. J. Pickle, Chairman
Subcommmittee on Oversight

JJP/sal

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

RECEIVED
MAY 22 1989
Ways and Means
Subcommittee on Oversight

May 22, 1989

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

On April 25, 1989, you asked us to respond to several questions relating to our April 4 testimony on the Administration's fiscal year 1990 budget proposal for IRS. The enclosure responds to your questions, except for those relating to Tax System Modernization and Computer Resources. Our Information Management and Technology Division will respond to those questions separately. Also, once we complete our analysis of IRS' mid-year financial review, we will contact your staff to set up a briefing.

If you or members of the Subcommittee have additional questions, you may contact me at 275-6407.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Enclosure

ENCLOSURE ENCLOSURE

FOLLOW-UP QUESTIONS TO GAO
TESTIMONY ON THE ADMINISTRATION'S
FISCAL YEAR 1990 BUDGET
PROPOSAL FOR IRS

I. OVERVIEW

1. Would GAO support an increase in funding, for certain accounts, over the fiscal year 1990 Administration budget request? If so, for which accounts and why?

GAO Response

As noted in our April 4, 1989, testimony before the Subcommittee, our primary concern is that IRS have sufficient money to fund current operations plus changes necessitated by legislative mandates and increasing workloads. In our testimony, we talked about a potential shortfall in fiscal year 1990 because the Administration's budget request (1) did not include funding to cover the costs IRS expects to incur in implementing three new pieces of legislation; (2) did not include sufficient funds for increased salaries, insurance premiums, and retirement benefits; and (3) included savings that OMB has determined IRS can achieve through efficiencies associated with assessing the possibility of contracting out certain jobs under OMB Circular A-76, but which IRS claims are unattainable. Consistent with our testimony, we would support increases in accounts affected by those areas.

Other needed increases may become apparent as the full effects of this year's shortfall are realized. For example, some cutbacks in areas like training, equipment, and supplies are being accomplished by deferring events or purchases until next year. Such deferrals might cause increased funding needs next year.

2. The Administration's fiscal year 1990 budget proposal did not include funds for implementation of the drug bill, the medicare catastrophic health care bill, and the technical corrections bill, which includes the taxpayer bill of rights. GAO has indicated that although the proposed IRS fiscal year 1990 budget increases over fiscal year 1989 funding, it may not be enough to maintain basic operations because of the additional costs of implementing this legislation. What types of problems could result in fiscal year 1990? Which of

IRS's basic operations stand a potential to decrease in fiscal year 1990 below its current level?

GAO Response

What eventually happens if IRS does not receive additional funds to implement new legislation will depend on the steps IRS management decides to take to deal with the shortfall. To deal with this year's shortfall, for example, management imposed a hiring freeze, furloughed temporary employees, deferred purchases of equipment and supplies, delayed space alterations, and imposed cuts in travel and training. At the same time, it tried to exempt certain activities, like answering taxpayers; telephone inquiries, providing forms and publications, and processing returns, from those actions. Faced with another shortfall next year, IRS might take many of the same actions. Coming on top of cuts in 1989, additional hiring freezes and furloughs and more cutbacks in such things as travel, training, and space alterations could have a significant impact on operations and employee morale. In the past hiring freezes and cutbacks have exempted Returns Processing and Taxpayer Service functions at the expense of compliance functions. It is possible IRS will be unable to continue to exempt these functions from future cuts which could cause a deterioration in those critical activities.

3. At the request of the Subcommittee, GAO has visited certain IRS service centers to determine the impact of the fiscal year 1989 funding shortages on IRS operations.

(a) GAO testified that the funding shortfall in fiscal year 1989 resulted in the deferment of equipment replacements, cancellation of plans to convert some staff from temporary to permanent positions, and curtailment of some compliance efforts. Would GAO provide specific details on each of these cutbacks and evaluate the impact?

(b) If there are no big problems thus far in 1989, are there areas which should be monitored throughout 1989 because a potential for difficulties exists?

(c) Are employees being furloughed? If so, why and from which activities?

(d) Please provide GAO's analysis of IRS's mid-year financial review, as soon as possible, for the record.

GAO Response

The information we received from our visits to the service centers and our discussions with officials in the National Office and in the field was generally not detailed enough for us to assess impact. With respect to supplies and equipment, for example, what we were told in Fresno was typical--there was a freeze on purchases of such things as computers, tables, and chairs. The Service Center Director in Fresno said that such a freeze, while not an immediate problem, could pose a problem in the future if funds are not provided in 1990 to replace the equipment that was not replaced in 1989. The same Service Center Director also said that the shortfall prevented the center from converting seasonal and temporary employees to permanent status, which could affect operations in fiscal year 1990.

We were told about several cutbacks in service center compliance efforts. In Fresno, according to the Director, there were cuts in the number of correspondence audits and in the number of nonfiler cases that are handled through the Substitute for Returns program. In Andover, we were told about cutbacks in various discretionary compliance programs involving self employment tax, minimum tax, and child support. At the National Office, Collection officials estimated that the hiring freeze would prevent the closure of 5,900 delinquent accounts with a resultant loss of about $15 million in revenues.

IRS recently completed its mid-year financial review. As noted in our testimony and later confirmed with your office, we will provide our analysis of that review as soon as possible. That analysis should enable us to speak more confidently about two other parts of your question--areas that should be monitored throughout 1989 and furloughs. It is clear from information we obtained in preparing for the April 4 hearing that temporary employees had been and were going to be furloughed. What was not clear was the extent of those furloughs and the degree to which the furloughing was due to the shortfall. As noted in our testimony, for example, Andover Service Center management said that 699 employees had been furloughed since January 1, 1989, but they attributed the furloughs not to

budgetary problems but to the facts that (1) attrition was lower than expected and (2) staff were more efficient and making fewer errors. In communicating the results of the mid-year financial review to the field, the National Office referred to the release of seasonal employees. In particular, the Director of IRS' Finance Division noted that:

> "Several programs in the service centers are being scaled back or deferred for the remainder of the year. These program changes may result in the release of seasonal employees."

In our analysis of the mid-year review, we will be seeking to get more specifics on the number of furloughs and the specific programs affected.

II. EXAMINATION AND APPEALS

1. The Administration has included a new revenue initiative in their fiscal year 1990 budget proposal which combines various examination activities including correspondence audits, closing unpaid tax accounts, and reconciliation of wage reports between IRS and the Social Security Administration.

   (a) Does GAO support this initiative?

   (b) What concerns are raised by the components of this initiative, such as the use of correspondence audits when GAO has raised serious questions generally about the quality of IRS' handling of taxpayer correspondence?

   GAO Response

   As a point of clarification, correspondence audits is the only activity among the three cited in the question that involves the Examination function. The other two activities--closing unpaid tax accounts and reconciling wage reports--involve the Collection and Returns Processing functions respectively. As noted in our April 4 testimony, we generally support the initiatives in the 1990 budget request. We have gone on record in the past as being supportive of efforts to increase IRS' audit presence and to reduce accounts receivable, and we have issued reports describing the need for IRS and the Social Security Administration to do a better job of reconciling wage reports.

As discussed in our testimony, we have two broad concerns about initiatives in the fiscal year 1990 budget proposal that go beyond the initiatives mentioned in your question. Our first concern is that neither we nor IRS know whether specific revenue initiatives represent the most efficient and effective use of additional enforcement resources. Our second concern involves the need to ensure that adequate resources are available to finance IRS' current operations before approving funds for new initiatives.

Questions we raised about the quality of IRS' handling of taxpayer correspondence were specifically directed at correspondence prepared by the service center's Adjustments/Correspondence Branch. That Branch is not responsible for handling or preparing correspondence associated with correspondence audits.

2. Is it possible for the IRS to increase the audit rate in fiscal year 1990 with fewer positions in examination?

GAO Response

According to the Administration's fiscal year 1990 budget request, IRS expects to increase audit coverage from 1.10 in 1989 to 1.23 in 1990 despite a slight decrease in Examination staffing. Whether audit coverage actually goes up remains to be seen. In the past few years, actual audit coverage has fallen far short of expectations. In the 1987 and 1988 budget requests, for example, IRS estimated audit coverages of 1.42 percent and 1.61 percent respectively. Actual audit coverages achieved in those years were much lower --1.10 percent and 1.02 percent respectively. Contrary to what one might reasonably expect, audit coverage has continued to decline even as Examination staffing has increased. In fiscal year 1976, for example, IRS had 28,164 average positions in the Examination function and reported an audit coverage of 2.43 percent. In fiscal year 1988, audit coverage had dropped to 1.02 percent while average positions had climbed to 34,097.

Despite past trends, we believe it is possible for the audit rate to increase despite fewer Examination positions. If Examination does less hiring, for example, experienced revenue agents who are responsible for training and coaching new hires would have more time to spend auditing returns.

3. In the past, GAO has noted that there is substantial lag between the hiring of examination agents and the point at which IRS collects additional revenues.

(a) Has the hiring freeze in Examination this year, and therefore the inability to fill staff attrition, resulted in the strong possibility that the IRS will not be able to meet revenue targets in fiscal year 1990?

(b) Based upon GAO's review of current IRS operations, is there any reason to believe that the IRS will not meet revenue targets for fiscal year 1989?

GAO Response

As noted in our April 4 testimony, the hiring freeze did not have its anticipated effect in Examination. Examination originally expected to reduce its staffing by about 1,000 positions nationwide as a result of the freeze but later adjusted that expectation to no more than 200 positions. With that in mind, and assuming the hiring freeze is not extended into the next fiscal year to deal with another shortfall, we believe it is reasonable to expect IRS to meet its Examination revenue target for fiscal year 1990. Another reason for believing that IRS should meet its revenue target is the fact that IRS' revenue estimates have historically been conservative. As noted in our August 1988 report on IRS' estimates of audit yield (GAO/GGD-88-119), estimates of the additional tax IRS would recommend from audits were understated by an average of 21 percent a year between 1983 and 1987. For fiscal year 1988, IRS had estimated that it would have 34,730 average positions in Examination, of which 17,955 would be revenue agents, and that it would recommend $19.0 billion in additional taxes. Even though IRS only realized 34,097 average positions, of which only 16,558 were revenue agents, it reported $19.9 billion in recommended taxes that year.

For the same reasons cited above, we believe it reasonable to expect that IRS will meet its Examination revenue target for 1989. Other revenue targets may be in jeopardy, however, especially those that are dependent on service center staffing. A preliminary analysis of IRS' plans for dealing with the budget shortfall during the rest of fiscal year 1989 indicates that significant cuts will be made to various revenue-producing service center programs, including the

Information Returns Program and the Underreporters Program.

4. GAO has researched various exempt organization issues for this Subcommittee over the past few years. Is GAO aware of any reason why the IRS audit rate for exempt organizations in fiscal year 1989 is now estimated at 2.5 percent, rather than the 4.67 percent noted in the fiscal year 1989 budget?

GAO Response

The Assistant Commissioner for Employee Plans and Exempt Organizations cited three factors that contributed to reduced audit coverage--time spent doing a study on private foundations, the extra time associated with auditing returns as part of a Taxpayer Compliance Measurement Program survey of Form 990-Ts (Exempt Organization Business Income Tax Return), and the time spent by experienced revenue agents in recruiting and training a significant number of new hires. We did not do any work to substantiate those reasons.

III. INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

1. How will the IRS's new responsibilities under the drug bill impact tax fraud investigation programs in fiscal year 1990?

GAO Response

We do not have sufficient information to answer this question with any certainty. According to IRS budget documents, the Anti-Drug Abuse Act of 1988 mandated, beginning in fiscal year 1990, that the Attorney General submit a separate appropriations request for expenses relating to all Federal agencies participating in the Organized Crime Drug Enforcement Task Forces. In accordance with that mandate, IRS' fiscal year 1990 budget request provides for 260 average positions and $14.4 million to the Department of Justice for organized crime related cases. When we talked to the Deputy Assistant Commissioner for Criminal Investigation in preparation for the April 4 hearing, he was uncertain how this shift in funding responsibility would affect IRS.

Documentation obtained from IRS indicated it would be affected by provisions in the Anti-Drug Abuse Act of

1988 dealing with international narcotics control, drug trafficking, money laundering, and the requirement of certain businesses to file Currency Transaction Reports. We do not have specific information on how these additional responsibilities will affect existing investigation programs.

2. Based upon GAO's findings, what is the impact of fiscal year 1989 funding levels on the Criminal Investigation Division, including programs and equipment?

GAO Response

We have the following information with respect to the impact of fiscal year 1989 funding levels on the Criminal Investigation function:

-- The Assistant Commissioner for Criminal Investigation said, in March 1989, that the hiring freeze would not adversely affect Criminal Investigation nationwide.

-- Also in March, the Deputy Assistant Commissioner for Criminal Investigation said that the shortfall in 1989 had caused his Division to cut back on purchasing equipment. He mentioned that the Division needed additional money to modernize its radio equipment, replenish its vehicle inventory, and buy modern weapons.

-- A preliminary analysis of the decisions made by IRS at its mid-year financial review indicates that $47,000 would be saved by the furloughing of temporary staff and another $29,000 would be saved through reductions in travel.

3. GAO reported at our hearing on the 1989 filing season that the taxpayer telephone assistance error rate was 34 percent, while IRS reported 37.6 percent incorrect. Since that time, GAO has continued to monitor IRS' test call system.

(a) What is the current telephone accuracy rate based upon GAO's monitoring?

(b) How will the fiscal year 1990 budget proposal improve the accuracy rate?

(c) Are there programs and/or funding which GAO would recommend for addition to the budget in order to improve the accuracy rate?

GAO Response

Our monitoring is designed to allow us to comment with 95 percent confidence on the accuracy rate produced by IRS' test of its assistors during the filing season. Overall, IRS' preliminary results indicate that the accuracy rate for its assistors during the filing season was about 62.8 percent. This is about the same as IRS reported during the Subcommittee's April 4, 1989, hearing on IRS' budget. We are unable to provide the final results of our monitoring at this time because we have not finished analyzing the data. Our preliminary analysis does, however, show a high degree of correlation between our scoring of monitored calls and IRS' scoring on those calls.

IRS' fiscal year 1990 budget proposes to significantly increase the ratio of permanent to seasonal and temporary assistor positions, continuing an initiative which began in fiscal year 1989. By so doing, IRS hopes to stabilize its work force and reduce its reliance on seasonal and temporary employees. IRS believes that more experienced staff results in greater assistor accuracy. As part of this proposal, IRS plans to about double the number of taxpayer service specialists--the higher-graded assistors. This, it believes, will create greater advancement opportunities for lower-graded assistors and thereby improve retention of the more qualified assistors. By retaining assistors longer, IRS will also be able to provide them with additional tax law training. We generally agree that increased experience levels, training, and advancement opportunities should improve assistor performance.

Concerning possible recommendations to improve the accuracy rate, we are not in a position, at present, to make recommendations since our work to date has been directed at determining the accuracy of IRS' telephone assistance program rather than identifying the causes of assistors' errors.

4. The number of taxpayers assisted in fiscal year 1989 is now estimated at 33 million which is far below the 44 million estimated in the 1989 budget. What is the reason for this decrease? Has GAO found the

availability of taxpayer service to be a problem this filing season?

GAO Response

IRS' 1990 budget submission contained estimates for fiscal year 1989 which were revised to reflect a decrease in authorized staffing from the 1988 authorized level. In 1988, Congress authorized Taxpayer Service approximately 1500 positions above its budget request with which IRS was able to assist 46.4 million taxpayers during the fiscal year. IRS' authorized level in 1989 did not include the staffing increase Congress provided in 1988 and thus IRS reduced its estimate of the number of taxpayers it planned to assist from 44.5 million to 33.2 million. In its 1990 budget submission, IRS indicated it would reprogram funds to taxpayer service, if possible, to maintain past levels of service. In actuality, IRS has reprogrammed approximately 1,000 net staff years to taxpayer service to help it achieve its service level to taxpayers.

Although IRS estimated, in its 1990 budget, that it would serve 33 million taxpayers in fiscal year 1989, IRS had already served about 30.7 million taxpayers through the end of April--25.7 million by telephone and 5 million at walk-in offices and through correspondence. By the end of the fiscal year, IRS expects to assist close to the 44 million taxpayers it had estimated would be served in the 1989 budget.

We did not find the availability of taxpayer service to be a problem this filing season. Although telephone demand during the filing season was higher than expected, IRS assistors answered more calls than IRS had planned. Even with the increased demand, IRS estimated it achieved an 82.7 percent level of service. Although lower than its goal of 85 percent, this was IRS' second best performance during the last decade, exceeded only by last year's service level of 84.5 percent. (See our report "Tax Administration: How Precise are IRS Estimates of Taxpayers Calling for Assistance" GAO/GGD-89-31 dated February 21, 1989 for a discussion of IRS' methodology for calculating their level of service).

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IV. RETURNS PROCESSING

1. What is in the Administration's fiscal year 1990 budget proposal to improve quality in those activities GAO has expressed concern about in the past: returns processing, error resolution, and adjustments and correspondence? Will the IRS be able to improve training and/or reduce high turnover rates in these areas?

GAO Response

There is only one item in the Administration's fiscal year 1990 budget proposal for IRS that is specifically identified as being intended to improve quality in the areas cited in the question. That item involves a request for 52 average positions and $2.0 million to "finance the use of a computerized Program Analysis System to monitor the quality and accuracy of adjustments and correspondence." As described in the budget request: "Error trends will be analyzed and corrective actions taken by providing additional training, management oversight and clerical support."

The fact that there are no items in the budget proposal that are specifically targeted at improving quality in other areas of the Returns Processing function does not mean that IRS is not taking or does not plan to take steps to make improvements in those areas. IRS has numerous quality improvement initiatives ongoing throughout the agency. Those efforts are funded as part of IRS' normal operations and do not appear as separate line items in the budget proposal. For example, in responding to the recommendations of one of our reports on the Error Resolution System ("IRS Can Reduce Processing Errors With Better Quality Controls and Information",GAO/IMTEC-88-25, August 8 1988) IRS is attempting to improve this system through (1) the use of review units nationwide, (2) a new process review program to track errors, and (3) a new training program on the use of Program Analysis System data. Such funds, however, would not directly show up in the budget as a line item.

IRS officials said that they have taken a number of actions and are planning a number of others to enhance the training of personnel involved in handling correspondence from and preparing correspondence to taxpayers. They assured us that those efforts have not been adversely affected by this year's budget shortfall. Nevertheless, training in general is one

area that is being cut significantly across IRS as a result of this year's budget shortfall. With that in mind and considering the possibility of another shortfall in 1990, as discussed in our April 4 testimony, we have serious reservations about IRS' ability to provide necessary training throughout the organization, not just in Returns Processing.

We do not know whether IRS will be able to reduce its turnover rates in the Returns Processing area. To the extent turnover is the result of noncompetitive salaries, however, we see nothing to suggest that the situation will improve.

2. Will increasing the Returns Processing staffing by 1,000 positions accommodate the increased fiscal year 1990 workload?

GAO Response

The Administration's fiscal year 1990 budget proposal calls for 31,090 average positions in the Returns Processing function--an increase of 968 average positions over fiscal year 1989. That increase is the net of (1) an increase of 567 average positions for various program changes, (2) an increase of 509 positions considered necessary to maintain current service levels, (3) an increase of 845 positions to deal with a projected growth in workload, and (4) a decrease of 953 positions as a result of nonrecurring items and anticipated savings.

There are several workloads to consider in assessing the adequacy of that increased staffing. One workload involves the processing of returns. Included in the requested staffing increase are 794 additional positions to process about 5 million more tax returns in fiscal year 1990 and about 1 million more supplemental documents (such as extensions to file). Because that is the same number of additional staff years IRS asked for in its original budget submission to the Department of the Treasury, we would expect it to be sufficient--assuming of course that the number of additional returns filed in 1990 does not significantly exceed IRS' estimate.

Another Returns Processing workload involves the reconciliation of wage reports under the Combined Annual Wage Reporting Program. The Administration's budget proposal calls for 455 additional positions in

ENCLOSURE

Returns Processing to enable IRS to work 332,000 more revenue-producing cases and up to 175,000 additional cases that cannot be resolved by the Social Security Administration. The additional staffing should allow IRS to resolve practically all the revenue producing cases and many other cases that SSA cannot now resolve. These resources should help IRS identify patterns of employers who are repeatedly responsible for such discrepancies.

Other Returns Processing workloads involve the various service center inventories, such as unpostables, error resolution, and adjustments/correspondence. Whether the Returns Processing staffing levels proposed for fiscal year 1990 are sufficient to keep each of those inventories within manageable limits at each of the service centers will depend, in part, on the status of those inventories at the end of fiscal year 1989. That status, in turn, will depend on the extent to which the fiscal year 1989 shortfall causes cases in these inventories to go unworked. In considering various options for dealing with this year's shortfall, some IRS regions proposed furloughing temporary staff in the service centers and predicted a significant growth in service center inventories as a result. As noted earlier, IRS just recently advised us of their official plans for dealing with the shortfall. We will provide our analysis of those plans, including any potential effect on service center inventories, as soon as possible.

Another factor that could affect the adequacy of the requested staffing for Returns Processing is the extent to which IRS realizes the projected savings of 863 staff years in this function. Of that projected savings, 318 was attributed to Electronic Filing and 545 was attributed to OMB Circular A-76. We discussed our concerns with the later item in our April 4 testimony.

GAO
United States
General Accounting Office
Washington, D.C. 20548

Information Management and
Technology Division

RECEIVED
MAY 22 1989
Ways and Means
Subcommittee on Oversight

MAY 22 1989

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

As you requested in your letter of April 25, 1989, we are forwarding information to complete the Subcommittee's April 4, 1989, hearing record on the Administration's fiscal year 1990 budget proposal for the Internal Revenue Service (IRS). Provided below are responses to questions 1 - 5, contained in section V of your letter, which address tax system modernization and computer resources issues. Our General Government Division will respond in a separate letter to the questions in sections I through IV of your letter.

Question 1: In addition to the Automated Examination System, is GAO aware of any other major automation initiatives that are currently experiencing significant technical difficulties leading to either higher costs, delays in implementation, or both?

Answer: On the basis of our work to date, we have reported that IRS has experienced implementation delays or other difficulties on at least two other projects. The Electronic Filing System is still experiencing some of the same problems that troubled it during the 1988 filing season. The system was developed and implemented before its nationwide requirements were clearly defined. A key software component developed for the 1988 filing season had to be completely rewritten for the 1989 filing season because it did not operate properly. In addition, the costs and benefits of the various alternatives to meet the requirements for a nationwide electronic filing system have not been identified or analyzed. The Communications Replacement System has also experienced delays because of an overturned contract award and a contractor's failure to produce a workable system. The system is

currently operational, but the contractor has yet to deliver acceptable systems documentation or correct some outstanding software problems. The software problems do not affect the processing of tax returns.

Question 2: Since at least 1978 the IRS has been attempting to formulate a long-range plan to modernize its aged computer systems. Why has it taken so long to reach agreement on such a plan? In GAO's judgement, does the Service now have the necessary management information on which to base the critical decisions it must make as part of Tax System Modernization?

Answer: IRS' current modernization efforts began in 1982. The delays in formulating a long range plan for tax system modernization since then occurred partly because of leadership changes within IRS and Treasury. Also, the initial redesign strategies were challenged because they did not clearly relate to IRS mission needs. We believe the establishment of the Office of Assistant Commissioner for Information Systems Development in 1987 and the issuance of an approved management plan in March 1988 give the Service a basic framework for modernization. Whether the steps IRS is now taking will result in a viable design master plan remains to be seen. At this point, IRS does not have sufficient information to formulate the master plan. For example, IRS does not have comprehensive workload data for either its current mainframe computers or its planned Service Center Support System computers which are a part of Tax System Modernization. IRS plans to make a decision on a general technical design for the modernization near the end of 1989 and issue a design master plan by October 1990.

Question 3: GAO also has been critical of the Service's planning and testing efforts in those computer modernization projects which have already been undertaken. In GAO's judgement, what presents the greater risk to the taxpayer and the Service: that the Service delays implementation of Tax System Modernization until it is more fully defined thereby increasing the risk that the new systems will not be in place in time to meet the coming computer capacity shortfall; or, that the

Service begin acquiring new systems immediately, and risk making false starts that could later prove costly and time-consuming to correct?

Answer: Our analysis shows that IRS can ensure sufficient computer capacity into the 1990's if it successfully implements capacity initiatives that it has identified. To the extent that the Service requires additional capacity to meet its basic tax processing requirements, we believe that immediate stop-gap action will need to be taken. However, we believe any short-term actions taken should be limited to satisfying immediate needs. Such stop-gap measures should not be considered part of the Tax System Modernization. Pressing forward with Tax System Modernization projects before the modernization is fully defined and planned could result in difficulty integrating the various components of the overall system, which could, in turn, lead to costly retrofitting.

Question 4: Does the IRS have a system in place to track the costs and progress of its major automation initiatives? Who is responsible for gathering, and to whom is it reported? Has the GAO requested this information, and has the Service honored this request?

Answer: As noted in our April 4, 1989 testimony, it has been difficult to track actual costs in the major IRS systems development projects. In particular, it is very difficult to track the cost of Tax System Modernization because the projects that comprise Tax System Modernization change from year to year. As we noted, in one year's time Tax System Modernization went from 5 projects to 17 projects. Those 17 projects included only 4 of the prior 5 projects. IRS then added all or parts of 11 existing projects not previously considered part of Tax System Modernization, as well as 5 new projects. Although IRS has always been cooperative in providing GAO with all the data it maintains, IRS does not have the cost data that would make it possible to track the cost of these or any other ADP development projects.

The Office of Information Systems Development is currently installing a new system for

tracking individual projects. This system is scheduled for full implementation by the end of Fiscal Year 1989. Since we have not analyzed this system, we do not know how effective it will be in tracking project costs.

Question 5: Is GAO aware of any problems with the capacity and timeliness of responses in the Distributed Input System at IRS service centers? If so, please describe the problems and evaluate steps being taken to correct them.

Answer: We are aware of only one problem involving slow Distributed Input System (DIS) response time which occurred March 22, 1989, at the Kansas City service center. The problem was principally due to an unusual workload pattern which, in turn, caused excessive response times during one phase of the DIS process. The Service changed its operating procedures, which returned the DIS to normal operations. According to IRS' Capacity Branch Chief, this problem has not recurred at Kansas City, nor has it occurred at any other service center.

We will be happy to answer any further questions you may have.

Sincerely,

for James R. Watts
Associate Director

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-236558

August 18, 1989

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

On April 25, 1989, as a follow-up to our April 4 testimony on IRS' budget request for fiscal year 1990,[1] you asked us to provide an analysis of IRS' mid-fiscal year 1989 financial review. On July 6, 1989, we briefed your staff on the results of our analysis. This letter documents the information provided at that briefing, supplemented by some additional data.

RESULTS IN BRIEF

Because cost-cutting measures taken earlier in fiscal year 1989 had proven insufficient to offset a $360 million budget shortfall, IRS, in May 1989, imposed additional cuts that were expected to make up the difference. According to IRS statistics and other information obtained from IRS officials, those cuts

-- have affected IRS' service to the public by making it more difficult for taxpayers to reach IRS over the telephone and by decreasing the manageability of certain service center correspondence inventories and

-- are expected to decrease the revenues derived from IRS' document-matching activities.

Other effects may become apparent next year depending on the extent to which (1) furloughed employees decide not to return to IRS (which could adversely affect the quality of IRS' returns processing activities) and/or (2) IRS is unable to fund items, such as space alterations, that were deferred until next year.

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[1] Administration's Fiscal Year 1990 Budget Proposals for IRS and the Tax Court (GAO/T-GGD-89-16, Apr. 4, 1989).

BACKGROUND

As noted in our April testimony, IRS had identified a fiscal year 1989 budget shortfall of about $360 million and had taken various actions in an attempt to offset that shortfall. Included among those actions were a hiring freeze and restrictions on travel, training, and equipment acquisitions. Those actions proved insufficient, however, primarily because the hiring freeze had not had its intended effect. As discussed in our testimony, for example, IRS' Examination function had originally expected to reduce its staffing by 1,000 positions but had to significantly reduce its estimate when it later realized that the level of attrition was much lower than expected.

During the mid-year review, IRS decided on additional actions that had to be taken to offset the remaining shortfall. As officially announced in a May 12, 1989, memorandum to IRS executives from the Deputy Commissioner for Planning and Resources, IRS decided to (1) make additional cuts to support services, equipment, training, and space alterations, (2) reduce various service center programs by furloughing temporary staff, and (3) limit the level of taxpayer service provided after the filing season.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to assess the results of IRS' mid-year review in terms of their effect or potential effect on IRS' operations. To do that, we analyzed documentation relevant to the mid-year review and talked with officials in IRS' Finance Office and in various program areas, such as taxpayer service and returns processing, affected by decisions made at the mid-year review. We also analyzed IRS statistics on the level of taxpayer service being provided and on the size and manageability of service center correspondence inventories.

We did our work from April to July 1989 and in accordance with generally accepted government auditing standards. We sought the views of officials responsible for the activities discussed in this report and incorporated their comments where appropriate. They generally agreed with the facts presented.

EFFECTS OF IRS' CUTBACKS

The full effect of IRS' cutbacks will not be apparent until after fiscal year 1989. Some degradation in IRS' service to the public is already discernible, however, and IRS expects some reduction in revenues as a result of cutbacks in the Underreporters Program. We believe that two additional issues are associated with the cutbacks, the effects of which, if any, will not surface until next year. Those issues involve whether (1) work quality in the service centers will be adversely affected by the unstable work environment created by furloughs and (2) sufficient money will be available in fiscal year 1990 to fund various activities, such as space alterations and equipment purchases, that IRS deferred from this year to next.

Service to the Public

As a result of IRS' cutbacks, the level of service to taxpayers over the telephone and through correspondence has been reduced.

According to IRS' statistics, for example, IRS had achieved a 72-percent level of telephone service[2] for the week ending July 29, 1989, compared with an 84.1-percent level of service during the same week last year. This year's level of service is lower than IRS had planned when it made its mid-year cuts in May. At that time, IRS expected the cuts to cause the level of service to drop to 75 percent. A drop in the level of service means that taxpayers are having a more difficult time contacting IRS over the phone. At this time of year, most taxpayers are calling IRS with questions not about the tax law, which is the case during the filing season, but about their individual accounts.

As a further indication of the increasing difficulty taxpayers are having in getting through to IRS over the telephone, IRS' statistics showed that 64.2 percent of the callers during the week ending July 29 got through on the first attempt. That rate of accessibility was down from 80.3 percent during the week ending May 13--the week the

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[2]IRS computes its level of telephone service by comparing the number of taxpayers' calls answered at its toll-free telephone sites with its estimate of the total number of taxpayers who tried to call.

National Office advised the field of the decision to reduce the level of service.

Another of IRS' decisions at the mid-year review was to cut 141 staff years from the service center correspondence program. It is under this program that the service centers respond to taxpayer inquiries about their accounts and notify taxpayers of IRS-initiated adjustments to their accounts. According to IRS' statistics, the 10 service centers had 695,619 correspondence cases in their inventories on July 28, 1989, compared with 585,125 at that same time last year--an increase of about 19 percent. More important than the absolute size of the correspondence inventory, however, is the inventory's manageability. A comparison of manageability on July 28 with manageability at the time the mid-year cuts were announced (May 12) would seem to reflect the effect of those cuts in the correspondence area.

Manageability of Correspondence Inventory

In assessing manageability, IRS uses three criteria. The first criterion is that the center's inventory not contain any uncontrolled cases that are older than 14 days. (If a service center expects to take longer than 14 calendar days to resolve a case, it is to control that case by entering it into a computerized database; otherwise the case is considered "uncontrolled.") The National Office considers a center to have exceeded this criterion if its uncontrolled inventory at the end of a week exceeds the total of its receipts for that week and the previous week. Using that measure, we determined that no center's inventory was in excess of the first criterion on either May 12 or July 28, 1989.

The second criterion for manageability is that not more than 20 percent of a center's inventory be older than 45 days (referred to as the overage rate). On May 12, 1989, the overage rate nationwide was 7.7 percent, no center had a rate that exceeded the 20-percent criterion, and one center (Kansas City, Missouri) had a rate over 10 percent. As of July 28, that situation has changed considerably. According to IRS' statistics, the overage rate nationwide had increased to 16.2 percent, 9 of the 10 centers had overage rates above 10 percent, and the rates for Kansas City and Philadelphia had grown past 20 percent. Kansas City's rate on July 28 was 29.9 percent; Philadelphia's was 20.2.

The third criterion for manageability is that a center's total inventory not exceed the equivalent of 3 weeks' production. To measure against that criterion, IRS divides a center's average production for the last 4 weeks into its ending inventory. If the result exceeds "3," the inventory is considered unmanageable. Using IRS' formula, we determined that three centers (Kansas City, Memphis, and Philadelphia) exceeded that criterion as of July 28. As of May 12, only Memphis' inventory had exceeded the criterion.

The National Office branch chief responsible for the correspondence program said that all centers had been instructed to redirect any resource savings in other programs to the correspondence area. He said that his office has been monitoring the situation in Kansas City and, as part of that monitoring, is tracking the center's daily receipts and closures. He also said that Kansas City developed an action plan and that the situation is improving. The branch chief said that he has also talked with Memphis and Philadelphia but is not overly concerned about their inventory levels.

Revenues

The cut of 141 staff years in the correspondence program was one of several cuts to service center programs resulting from the mid-year review. In total, IRS decided to reduce service center staffing by about 750 staff years with an expected savings of about $12.5 million. The biggest service center staffing reduction was in the Underreporters Program, which sustained a cut of 469 staff years. Under that program, service centers follow up on cases identified through document matching in which taxpayers appear to have underreported their income. According to the headquarters branch chief responsible for that program, the reduction will cause service centers to work fewer cases, which, he estimated, will ultimately result in a total revenue loss of about $100 million, most of which will occur after fiscal year 1989.

As a result of its mid-year review, IRS had also intended to reduce staffing in another aspect of the document-matching effort--that which involves converting data to tape from information documents submitted on paper (as opposed to those submitted on magnetic media). Because paper information cannot be matched until it is converted, this cut, according to IRS officials, would have excluded certain information from the matching process. The potential impact on taxpayer

equity and revenues caused IRS to rethink its decision. By restoring some staff years to the conversion effort and extending the time frame in which that conversion had to be done, IRS now expects to use all of the paper information.

IRS also cut some staff in the Automated Collection System. According to a Collection official in the National Office, that cut will have no impact on revenues because it involved clerical positions.

Service Center Quality

Many service center employees are classified as seasonal or temporary workers. They work for only part of the work year, and many return to work at the center in succeeding years. IRS officials told us that many temporary staff in the service centers work several months a year and move from one area of the center to another depending on the time of year. Staff who help process returns during the filing season, for example, might move to the correspondence or underreporters area once the filing season winds down.

Cuts to the correspondence and underreporters programs, as discussed above, were accomplished by furloughing some of that staff. To the extent furloughed staff choose to seek a more stable employment and thus not return to the service center next year, IRS will be forced to hire inexperienced staff. The more IRS has to rely on inexperienced staff, the more it has to spend on training and the greater the probability that work quality will decline. The extent to which furloughed employees choose not to return to IRS and the effect, if any, on quality will not be known until the 1990 filing season. We intend to pursue the issue as part of our annual assessment of filing season activities for the Subcommittee.

Deferrals

Some of the cuts made by IRS in an attempt to deal with this year's shortfall involved the deferral of expenditures until next year. The Southwest Region, for example, planned to save about $2.3 million by deferring a major office relocation in Houston, Texas. Training was another area affected by deferrals. To help the regions make funding decisions in that area, the National Office provided them with guidelines for identifying mandatory courses. As explained to us by an Examination official, for example, each

region was expected to provide the mandatory examination training. The extent to which any nonmandatory examination training was provided, if at all, was left to the individual region, depending on its particular fiscal situation. Among the many training courses that the Central Region considered deferring, for example, was Phase IV of the revenue agent training program. During that phase of their training, agents learn about examining partnership returns.

Deferring such things as space alterations, relocations, equipment purchases, and training may help IRS make it through fiscal year 1989. The need to pay for those items in 1990, however, could cause funding problems next year.

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As agreed with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of issuance. At that time, we will send copies to the Secretary of the Treasury, Commissioner of Internal Revenue, Director of the Office of Management and Budget, and other interested congressional committees.

David Attianese and Sharon Paris of my staff contributed to the preparation of this report. If you or your staff have any questions concerning the report, please call me on 272-7904.

Sincerely yours,

Paul L. Posner

Paul L. Posner
Associate Director
Tax Policy and Administration
Issues

(268363)

Chairman PICKLE. Now, the Chair asks former IRS Commissioner Lawrence B. Gibbs if he will please come forward.

Our next witness is our old friend, Lawrence Gibbs, who served us well as our Commissioner here the last 2½ years, I guess it's been, and now has resigned and rejoined his old firm. I understand they've named the firm partially after you, or at least your name will be in the firm.

Mr. GIBBS. That's true, Mr. Chairman, Johnson & Gibbs.

Chairman PICKLE. So there's some improvement there, either in your own personnel regard or for your own recognition.

We appreciate your coming here today and your willingness to testify, Mr. Gibbs. You've given us great service, and I for one want to repeat again how much I appreciate the leadership you've given in taxpayer service. You've made the service centers cognizant of the fact that they have got to keep giving positive service to the taxpayers, and that can help correct a lot of the misinformation and misjudgment taxpayers may be making about tax collectors.

So we appreciate your coming here and testifying. We welcome you here.

STATEMENT OF HON. LAWRENCE B. GIBBS, JOHNSON & GIBBS, FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. GIBBS. Thank you, Mr. Chairman. It is late in the morning and I am not going to take you through my written statement which I have submitted for the record.

Let me just summarize it this way. Let me summarize it by returning my thanks to you and the other members of this subcommittee. Because I really think over the last several years, with your support in particular, and that of the other subcommittee members, and, indeed, of the entire committee, generally speaking, the Internal Revenue Service has been pretty well funded.

I am concerned about the future, and the basis for my concerns are set forth in my statement. I will not repeat them. I will simply call your attention to the recommendations that I have made on pages 5 and 6 of my statement.

And in those five recommendations that are made, I think that they pretty well target the areas of my concern. Specifically, those recommendations are to urge you to continue your future support, in light of your past support, of Internal Revenue Service, in order to first minimize the change and complexity in the tax laws with which taxpayers and IRS must deal.

Second, to reduce the pay disparity between the public and private sectors, to enable the Internal Revenue Service to continue to recruit and retain qualified professional employees to deal with taxpayers.

Third, to provide IRS with resources needed to improve its service and assistance to taxpayers who are trying to comply with their tax obligations, and also to deal with taxpayers who are not complying with those obligations.

Fourth, to support the Service efforts to modernize its computers and information systems, to provide better communication and assistance to taxpayers as well as to the employees of the Internal Revenue Service.

And fifth, and finally, to assist the Internal Revenue Service in obtaining the budget resources it needs to cope with the present and the anticipated resource shortfalls in the current fiscal year, and also in the 1990 fiscal year.

As I state in my conclusion, these recommendations are really customer oriented, in the sense that if these actions are not taken I am very concerned that the American public will be poorer for it, and that our society, which our tax system supports, will be poorer for it.

And conversely, if the actions are taken, then the winners are going to be your constituents who, over the last 3 years, the Internal Revenue Service has come to call their customers, namely, the American public.

I welcome your comments, and questions, as always, Mr. Pickle.

[The statement of Mr. Gibbs follows:]

STATEMENT OF
LAWRENCE B. GIBBS
FORMER COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT OF THE
HOUSE WAYS AND MEANS COMMITTEE
APRIL 4, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO APPEAR BEFORE YOU TO DISCUSS THE BUDGET SITUATION OF THE IRS FOR FISCAL YEARS 1989 AND 1990. I DO SO IN MY CAPACITY AS A PRIVATE CITIZEN BUT WITH THE KNOWLEDGE OBTAINED, AND ATTITUDES DEVELOPED, OVER THE LAST TWO AND ONE HALF YEARS THAT I SERVED AS COMMISSIONER OF IRS.

THE PAST AND THE PRESENT

OVERALL I BELIEVE THAT THE TAX ADMINISTRATION SYSTEM IN THIS COUNTRY PRESENTLY IS IN GOOD SHAPE. THIS YEAR IRS WILL COLLECT ALMOST $1 TRILLION BEFORE PAYING REFUNDS; NEXT YEAR, ALMOST $1 TRILLION AFTER REFUNDS. WITH THIS REVENUE WE PAY FOR THE BENEFITS THAT ALL OF US ENJOY IN THIS COUNTRY AND AROUND THE WORLD.

IN ORDER FOR OUR TAX SYSTEM TO CONTINUE TO FUNCTION PROPERLY, OUR CITIZENS MUST BE BOTH WILLING AND ABLE TO COMPLY WITH THEIR TAX OBLIGATIONS. THIS, IN TURN, REQUIRES THAT IRS BE ADEQUATELY FUNDED TO ASSIST THOSE WHO ARE TRYING TO COMPLY AND TO DETECT THOSE WHO HAVE FAILED TO COMPLY. IN MY OPINION A STRONG, WELL FUNDED IRS IS THE KEY TO ENSURING THAT TAXPAYERS WILL REMAIN WILLING AND ABLE TO COMPLY, AND THEREFORE TO ASSURING THE INTEGRITY OF THE TAX SYSTEM ITSELF.

DURING MY TENURE AS COMMISSIONER I BELIEVE THE ADMINISTRATION AND CONGRESS GENERALLY PROVIDED THE NECESSARY RESOURCES TO IRS. THERE ARE SEVERAL REASONS, I THINK, WHY OVER THE LAST THREE YEARS THESE RESOURCES HAVE BEEN FORTHCOMING, INCLUDING:

1. A RECOGNITION IN LIGHT OF THE DIFFICULTIES OF THE 1985 FILING SEASON THAT A FAILURE TO FULLY FUND IRS ADVERSELY AFFECTS ALL OF OUR CITIZENS,

2. A REALIZATION THAT ALTHOUGH MOST TAXPAYERS PAY THEIR TAXES, THERE IS A SUBSTANTIAL AND GROWING AMOUNT OF UNPAID TAXES WHICH IRS CAN AND SHOULD COLLECT, AND

3. AN UNDERSTANDING THAT THE MAGNITUDE AND COMPLEXITY OF THE TAX REFORM ACT OF 1986 REQUIRES ADDITIONAL IRS FUNDING TO ASSIST TAXPAYERS IN UNDERSTANDING THE TAX LAW CHANGES AFFECTING THEM.

SIMILARLY, I BELIEVE IRS HAS UNDERSTOOD THE IMPORTANCE OF:

1. IMPROVING THE QUALITY OF THE GOODS AND SERVICES IT IS PROVIDING TO ITS CUSTOMERS, THE AMERICAN PUBLIC,

2. INCREASING THE PRODUCTIVITY OF ITS WORKFORCE TO BETTER UTILIZE ITS RESOURCES, AND

3. MODERNIZING ITS COMPUTERS AND INFORMATION SYSTEMS THAT ARE THE VITAL INTERNAL AND EXTERNAL COMMUNICATION LINKS IN OUR TAX SYSTEM.

ALTHOUGH THERE IS CERTAINLY ROOM FOR IMPROVEMENT, I BELIEVE IRS HAS USED THE RESOURCES IT HAS RECEIVED OVER THE LAST THREE YEARS TO DELIVER IN EACH OF THESE IMPORTANT AREAS.

THE FUTURE

I FRANKLY AM CONCERNED ABOUT THE FUTURE. MEMORIES OF THE 1985 FILING SEASON PROBLEMS DIM OVER TIME, PARTICULARLY AS IRS CONTINUES TO DELIVER GOOD FILING SEASONS EACH YEAR. POLITICAL RHETORIC ABOUT THE NUMBER OF IRS AGENTS "UNLEASHED" BY REVENUE INITIATIVES IGNORES THE GROWING AMOUNT OF UNCOLLECTED TAXES, THE UNFAIRNESS TO THOSE WHO DO COMPLY OF FAILING TO COLLECT FROM THOSE WHO DON'T AND THE FACT THAT WE ARE AUDITING ONLY ONE PERCENT OF TODAY'S TAXPAYERS.

I AM ALSO CONCERNED THAT THE SUCCESSFUL IMPLEMENTATION BY IRS OF THE 1986 TAX REFORM ACT DIMINISHES THE FACT THAT THE 1986 ACT IS ONLY ONE OF THE 138 LAWS THAT HAVE BEEN PASSED OVER THE LAST THIRTEEN YEARS CHANGING THE TAX RULES WITH WHICH THE AMERICAN PUBLIC MUST DEAL. SINCE 1986 THERE HAVE BEEN THIRTEEN NEW TAX LAWS, EIGHT OF WHICH WERE PASSED IN LAST YEAR ALONE. THE MAGNITUDE AND VELOCITY OF ANNUAL TAX CHANGES HAVE REACHED THE POINT, IN MY OPINION, WHERE THEY ARE AFFECTING THE ABILITY AND WILLINGNESS OF THE PUBLIC TO COMPLY WITH THEIR TAX OBLIGATIONS AND THE ABILITY OF IRS TO EFFECTIVELY ADMINISTER THE TAX SYSTEM.

I AM CONCERNED THAT IMPROVEMENTS BY IRS IN THE QUALITY OF IRS GOODS AND SERVICES AND THE PRODUCTIVITY OF ITS WORKFORCE MASK THE IMPACT OF THE INCREASING DISPARITY BETWEEN PUBLIC AND PRIVATE SECTOR PAY. IRS COMPETES FOR EMPLOYEES WITH ACCOUNTING, LEGAL AND COMPUTER SKILLS. DEMOGRAPHIC STUDIES OF THE WORKFORCE TELL US THAT COMPETITION FOR THESE SKILLS CONTINUES TO INCREASE. COMMON SENSE TELLS US THAT THE GROWING DISPARITY BETWEEN PUBLIC AND PRIVATE SECTOR SALARIES FOR THESE INCREASINGLY SCARCE SKILLS MEANS IRS WILL BE INEVITABLY LESS COMPETITIVE IN THE LABOR MARKET. A RECENT GAO REPORT TELLS US THAT IN THE NEXT THREE YEARS ALONE IRS WILL LOSE AT LEAST 30 PERCENT OF ITS TOP EXECUTIVES BECAUSE OF THIS PAY DISPARITY.

I AM ALSO CONCERNED THAT EVEN AS IRS TAKES THE BEGINNING STEPS TO REPLACE ITS OUTDATED COMPUTER SYSTEM, WE FORGET THAT LAST FALL THE CONGRESS CUT THE 1989 IRS COMPUTER BUDGET BY $100 MILLION. A SIMILAR OCCURRENCE FOR THE 1990 YEAR COULD BE DISASTROUS AND SHOULD BE AVOIDED IN ANY EVENT.

I AM VERY CONCERNED WITH THE PRESENT IRS BUDGET SITUATION. I HAVE PREVIOUSLY INDICATED THAT IRS THIS YEAR FACES A BUDGET SHORTFALL OF OVER $350 MILLION, ALMOST 7 PERCENT OF ITS CURRENT ANNUAL BUDGET. TO RESPOND TO THIS SHORTAGE, IRS IS IN THE MIDST OF A FULL HIRING FREEZE IN MOST OF ITS OPERATIONAL AREAS. IN ADDITION TRAINING, TRAVEL, SUPPLIES AND EQUIPMENT EXPENSES ARE BEING CURTAILED. MOVING AND COMMUNICATION OUTLAYS ARE BEING DEFERRED.

IT IS NOT CLEAR WHAT THE IMPACT OF THESE ACTIONS WILL BE ON IRS OPERATIONS AND TAXPAYERS. BECAUSE OF THE UNCERTAINTY OF THIS IMPACT, IT IS ALSO UNCLEAR WHETHER OR NOT ADDITIONAL ACTIONS MAY BE NECESSARY TO ADDRESS THE SHORTFALL, AND IF THEY ARE NECESSARY, WHAT THESE ADDITIONAL ACTIONS WILL BE.

IN ANY EVENT, IN MY OPINION ADDITIONAL FUNDING OF IRS WILL BE NECESSARY TO ADDRESS THE PROBLEMS CAUSED BY THE CURRENT BUDGET SHORTFALL. I URGE THAT IN NO EVENT SHOULD THE SHORTFALL BE PERMITTED TO CONTINUE INTO FISCAL YEAR 1990. I AM CONCERNED THAT THE PROPOSED BUDGET FOR 1990 WILL NOT BE SUFFICIENT TO ADDRESS THESE PROBLEMS, PARTICULARLY IN LIGHT OF THE BUDGET DIFFICULTIES IN 1989 AND THE INCREASING IRS WORKLOAD.

RECOMMENDATIONS

THIS SUBCOMMITTEE HAS BEEN GENEROUS AND UNSTINTING IN THE SUPPORT IT HAS PROVIDED TO ME, IRS AND THE AMERICAN PUBLIC OVER THE LAST THREE YEARS, PARTICULARLY IN ATTEMPTING TO SECURE THE RESOURCES NEEDED BY IRS TO FAIRLY, EFFECTIVELY AND EFFICIENTLY ADMINISTER THE TAX SYSTEM. I PERSONALLY THANK YOU FOR YOUR PAST SUPPORT. I URGE YOU TO CONTINUE FUTURE SUPPORT OF IRS IN ORDER TO:

1. MINIMIZE THE CHANGE AND COMPLEXITY IN THE TAX LAWS WITH WHICH TAXPAYERS AND IRS MUST DEAL,

2. REDUCE THE PAY DISPARITY BETWEEN THE PUBLIC AND PRIVATE SECTORS TO ENABLE IRS TO CONTINUE TO RECRUIT AND RETAIN QUALIFIED, PROFESSIONAL EMPLOYEES TO DEAL WITH TAXPAYERS,

3. PROVIDE IRS WITH THE RESOURCES NEEDED TO IMPROVE ITS SERVICE AND ASSISTANCE TO TAXPAYERS WHO ARE TRYING TO COMPLY AND TO DEAL WITH TAXPAYERS WHO ARE NOT COMPLYING,

4. SUPPORT THE IRS EFFORTS TO MODERNIZE ITS COMPUTERS AND INFORMATION SYSTEMS TO PROVIDE BETTER COMMUNICATION AND ASSISTANCE TO TAXPAYERS AND IRS, AND

5. ASSIST IRS IN OBTAINING THE BUDGET RESOURCES IT NEEDS TO COPE WITH THE PRESENT AND ANTICIPATED RESOURCE SHORTFALLS IN THE 1989 AND 1990 FISCAL YEARS

MY REQUESTS ARE CUSTOMER-ORIENTED. IF THE ABOVE ACTIONS ARE NOT TAKEN, THE LOSERS WILL BE THE AMERICAN PUBLIC AND ULTIMATELY THE AMERICAN SOCIETY WHICH OUR TAX SYSTEM SUPPORTS. CONVERSELY, IF THE ABOVE ACTIONS ARE TAKEN, THE WINNERS WILL BE YOUR CONSTITUENTS WHO ARE THE IRS CUSTOMERS AND OUR WAY OF LIFE IN THIS COUNTRY WHICH OUR TAX DOLLARS MAINTAIN.

AS ALWAYS, I WELCOME YOUR COMMENTS AND QUESTIONS.

Chairman PICKLE. I appreciate your recommendations and have noted them. I want to comment on them, but let me first comment about your overall analysis of the present budget situation.

I take it you are saying to me that the Internal Revenue Service has been able to get by this year, although they have had to absorb additional costs in three or four different areas.

But, that you are concerned about a shortfall, or any cutting of the budget figures for 1990. If in this next budget we do not put in sufficient money the Internal Revenue Service will have serious difficulties. Am I stating it correctly?

Mr. GIBBS. I am concerned about this year, Mr. Pickle, the 1989 fiscal year. I think we still have the rest of the current fiscal year to play out before us. So far this year, we are what, about halfway through the present fiscal year?

Chairman PICKLE. Yes.

Mr. GIBBS. So far through the present fiscal year I think that actions have been taken without, as best I can tell, substantially impacting the operations of the Internal Revenue Service, or the taxpayers as they relate to the tax system.

But I must tell you that given the magnitude of the shortfall, I, frankly, am concerned, and as you said—I believe you said in your opening statement—or as has been said this morning, I think we ought to take a hard look at where the Service is after the end of April, after the reports come back from the field in terms of where the operations are in attempting to determine what the impacts are going to be in the last half of the current fiscal year.

I think that will also give you a handle, quite honestly, on what the impacts are likely to be for fiscal year 1990, and I urge that this be done because I am concerned that there could begin to be a substantial impact in terms of IRS operations and taxpayers in fiscal year 1990.

Chairman PICKLE. If it is possible to have a serious budget problem for the rest of this year, do you think that the Internal Revenue Service will request supplemental funds to operate in order to prevent a possible catastrophe or possible lack of service?

Mr. GIBBS. As you know, supplemental has been previously requested by the Internal Revenue Service, and was not agreed to. I would anticipate that after the April timeframe, when the folks in the national office of the Internal Revenue Service have a better idea as to what the impact is going to be, I would think they would be making that decision at that time. I do not know what they will do.

Chairman PICKLE. Well, we will watch that. We know that they had requested $170 million this year in supplemental appropriations and it was turned down.

Mr. GIBBS. Yes, sir.

Chairman PICKLE. Now they have had to tighten the belt, tighten up every aspect, and I suspect they may be operating with less employees than needed. We will get some testimony from the NTEU group in a few minutes.

But you are saying the danger is still there, and we ought to take another look at it after the season ends to see if we need additional funds just for this year, and then certainly maintain an adequate funding level from 1990 on?

Mr. GIBBS. Correct.

Chairman PICKLE. All right. Now Mr. Commissioner, one of your first recommendations was that you would minimize the change and complexity in the tax laws with which taxpayers and IRS must deal. Are you just saying don't pass any more tax laws?

Mr. GIBBS. No. I do not think you have to be for a moratorium to be against the number of changes that have taken place over the last 13 years, or, indeed, over the last 2 years.

Chairman PICKLE. Just level off?

Mr. GIBBS. That is correct. I mean, I look at it this way, Mr. Chairman. I do not think it is realistic to talk in terms of a moratorium—no new tax laws. But I do think it is realistic to think in terms of minimizing the changes that take place.

Chairman PICKLE. Well, essentially, the 1986 tax law has remained in place. There has been very little assault against it.

The chairman of this committee, and the chairman of the Finance Committee have, together, just simply protected the act, in order for us to be familiar with it before we start making changes. I assume what you are saying is that we ought not to be passing a bunch of these laws.

Mr. GIBBS. I congratulate you for that. But, as has been discussed here this morning, the IRS is presently dealing with, for example, the Technical Corrections Act, the Anti-Drug Abuse Act, and the Catastrophic Medicare Act. All of those acts have real impact on the tax administration. I am simply saying this: That kind of impact, particularly when it is unfunded, makes it very difficult for the agency.

Chairman PICKLE. In one of your recommendations you said you would reduce the pay disparity between public and private sector, in order to keep good IRS people. The GAO testified a little earlier that they thought attrition would be a problem, but they said that IRS has had less attrition this year than they had thought.

In other words, the seasoned IRS people had stayed on board. Is attrition a problem now?

Mr. GIBBS. I am delighted that with the changes that have been made, I think the Internal Revenue Service is a more attractive employer. I think that is one of the reasons why you will see the attrition drop from, say, 10 or 11 percent to 4 percent.

But I submit to you, that if these kinds of budget crunches continue, then I think you are going to see the attrition escalate again. I would also point out that the GAO testified that Internal Revenue Service needs more people with computer backgrounds, and that is certainly true in the accounting and legal areas.

But I would point out that those are the very skills that are becoming more and more in demand. My only point is that as computer skills, accounting skills, and legal skills become more and more in demand, and there is a wider disparity between public and private sector, then I think you are going to have a harder time attracting and retaining good people.

Chairman PICKLE. You say that we should provide the Internal Revenue Service with the resources needed to improve its service and assistance to taxpayers who are trying to comply with the tax laws. What do you mean by that? What resources are needed? Such as what?

Mr. GIBBS. Well, again, the discussion—as was pointed out in the hearing this morning—deals basically with what the Internal Revenue Service is receiving to enhance taxpayer service. Even with the 1990 budget, those funds are going to permit the Service to basically maintain what it has, and it seems to me that there is a case to be made for the idea that you will actually increase compliance by providing more assistance to taxpayers, particularly as the laws change, and the society and the economy become more complex, and therefore the tax laws do too.

I would hope that the research projects that the Internal Revenue Service has to determine the revenue impact of taxpayer assistance actions could be brought to conclusion, so that those results could be shared, and so that perhaps we could begin to get consensus that you can make money by spending money in the taxpayer assistance area, just as there seems to be general agreement that you can make money by spending money on tax enforcement.

Chairman PICKLE. Earlier, I had said to the GAO and IRS both, that I think the most serious problems we really face in the operation of the Internal Revenue Service is not just the personnel, keeping highly qualified people aboard, but in getting the equipment we need.

You are quoted in the paper as saying, very prominently, that we are operating under the old ice age equipment status. I do not think I have found anybody who does not agree, generally, that our equipment down there is old and outdated, and may last for another few years.

But, unless we can decide what to put into place, what it would cost, set up the management team to put it in effect, and budget for it, honestly saying that we have got to have this money, we are going to find that we will not have sufficient time.

I am asking you: Is that a serious worry? Is it as bad as I picture it is going to be?

Mr. GIBBS. Well, I think your concern is well-founded, Mr. Chairman. I really do. I think that, as I say in my written testimony, the computer system that the Internal Revenue Service has is really the means by which it communicates and operates, not only internally, but also with the American public. And the computer system itself, the basic system—not just the machines but the basic overall configuration and the way it works—is very, very badly outdated. Therefore the Internal Revenue Service really cannot provide the public, the American taxpayers, with the kind of service that they have come to expect in dealing with banks, savings and loans, and other financial institutions.

Chairman PICKLE. Do you know what kind of system the Internal Revenue Service is going to put into place in the 1990–95 period?

Mr. GIBBS. As was testified to this morning by both the Internal Revenue Service and GAO, the overall type of system is there. What the Internal Revenue Service is doing, with that overall approach to the system, is now coming back and looking at alternatives in light of the current technology. That is where they are in the process.

So what I am saying is, yes, I think that there is an approach, a plan, a vision, if you will, in terms of what it will be and how it will work.

Chairman PICKLE. I am afraid that the Internal Revenue Service, over a period of years, has been faced with this crisis, which we knew was out there. We have remodernized, so to speak, our front-end processors, but we never have put into place any kind of program for the mid-1990's on.

Now, you tell me that the system is agreed to and they are ready to move forward. I would like to feel that we are going to try to establish more clearly if that is in effect the truth.

I think, though, they have taken the attitude, over the years, that it is going to be so costly, and so difficult to decide what system to put into place, that they have backed off and backed off because of the indecision on the system, and, knowing what it is going to cost, the fear of recommending so much money.

They are just like the young boy who gets on the diving board. He goes out there and he prances up and down a little bit and backs off. And, he prances around, and he never dives into that cold water.

The time is coming where we have got to dive, and if we do not have assurances up here, somebody is going to be held accountable for this lack of planning.

I know we are concerned about it. I would like to feel that a system is in place. You do give me encouragement that they have an agreed system, and I hope that is so.

Mr. GIBBS. Well, let me see if I can give you some more positive types of things.

The Office of Management and Budget, several years ago, themselves targeted this as one of the President's own initiatives. What that means, Mr. Pickle, is that it receives top-level oversight within the Office of Management and Budget.

I have, for example, over the last several years, on an annual basis, been over to talk to the Office of Management and Budget, the people at the top of it, about how we were doing on it, what their criticisms were, what their concerns were. And, frankly, as I came in there was a lot of concern—as there was down here—about it.

I must tell you that last fall was the first year that they did not ask me to come over to actually go over the detailed plans. I got a letter saying that their staff had reviewed it. They felt that the plan that had been developed, and the way that the Internal Revenue Service was proceeding were fine. They simply indicated a desire that the Service adhere to the timeframes and the time schedules for actually doing what the plan called for.

That is what the Service is doing, and I understand you will see something concrete with respect to actual requests for procurement by the end of the current calendar year.

And for that reason there is certainly cause for concern, in terms of the magnitude and the difficulty of the project, I think progress is being made, and what I would simply urge you to do what you have done in the past. Not only in your oversight role, but also, Mr. Pickle, just what you did last fall in terms of attempting—not only with the administration, but also with the Congress—to avoid a recurrence of the $100 million cut that the data-processing program last year received on the Senate side, and therefore by Congress in the data-processing area.

I urge that that not be repeated this year. You were very good in terms of your support, and I would urge you to continue to support the budget.

Chairman PICKLE. We should support your request if we are convinced that it is needed. In times of such severe budget constraints it is not easy to get all the money we need.

One of the big problems we have had is that down, the street, the administration will not let you request what you really need, or at least they will not give you what you need, because they have to look at a bigger picture.

I recognize that. But if this administration wants the Internal Revenue Service to continue the volunteer compliance system that the American people want and expect, they are going to have to fund it. And, they have got to see that we keep the right kind of equipment there and we keep the right kind of personnel. If they do not do that, you are not going to have a first-class system.

I think we are making headway. I think in the taxpayer services, alone, you have given great leadership and I want to support your request, but we cannot help, really, unless you ask for it.

Mr. GIBBS. Mr. Pickle, I understand that. Let me just comment to you that one of my biggest supporters over the last 3 years, while he was at the Treasury, was Dick Darman. Mr. Darman was very, very supportive of the proposals that I made while I was Commissioner.

Chairman PICKLE. Well, we had hoped that Mr. Darman would have been here today. We asked Mr. Darman to appear before us because we need his very strong endorsement, and evidence that he is going to support us. I thank you very much, again, for your testimony.

I am sorry that we have kept you here this long. I appreciate your courtesy in allowing Judge Nims to come in ahead of you.

That just indicates to me, though, that you are in private practice, and you would understand that and accept that change in our schedule because you might be going before his court some day.

Mr. GIBBS. Absolutely, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Gibbs. We are very proud of what you have done.

Mr. GIBBS. Thank you.

Chairman PICKLE. Now, we have one more witness, Mr. Robert Tobias, president of the National Treasury Employees Union. If Mr. Tobias would come forward.

Mr. DORGAN [presiding]. Mr. Tobias, thank you very much. You are the final witness today. We took Chief Judge Nims out of order, but we thank you very much for appearing and we would like to have you summarize your statement, and your entire statement will be made a part of the permanent record. You may proceed.

STATEMENT OF ROBERT M. TOBIAS, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Mr. TOBIAS. Thank you very much, Congressman Dorgan.

I am pleased to be present to talk about the very urgent need for financial support for the Internal Revenue Service, and particularly, for supplemental funding for fiscal year 1989.

First, let me summarize the very large challenges facing the Internal Revenue Service. Our growing population is generating millions of new tax returns to process each season.

Frequent tax law changes are making our life more complicated. As Acting Commissioner Murphy pointed out, there have been 138 separate public laws which amended the Internal Revenue Service since 1975, and 13 new laws since the Tax Reform Act of 1986.

I would also like to point out that voluntary compliance is stuck at 82 percent with the tax compliance gap expected to be $113 billion by 1992, and, in addition to that gap, there is $56 billion outside in accounts receivable.

If we were at a 92-percent compliance, we would have an additional $72 billion flow into the Treasury, and the reasons for this failure are simple. Audit coverage is now at 1 percent. We have too few revenue officers to work the TDA's—the tax delinquent accounts—and inadequate pay and training limit the IRS' ability to recruit and retain competent people.

As I point out in my full statement, Mr. Dorgan, the IRS needs $204 million as a supplemental budget for fiscal year 1989 to assist in absorbing the uncontrollable costs which have been assigned to the Internal Revenue Service.

The lack of funds is creating serious problems for the tax administration system today. Compliance activities in service centers are down significantly. For example, last year, there were 1,152 in the exam branches, and this year we are at 555. Last year, there were 914 in collection, and this year, 470.

Some districts are cutting back travel costs so that employees may travel only to taxpayers within a 10-mile radius. So if you live 11 miles away from the posted duty, you do not get audited.

Chairman PICKLE. Mr. Tobias, let me interrupt you for just a minute. I have got to go to a luncheon, and I want you to know that I appreciate your presence here. We have looked at your testimony and I have talked with some of the members of your organization, both locally and nationally. We are concerned about some of the same points you are talking about.

We are going to be examining, closely, the budget crunches affecting the employees so, I want to thank you for coming and being with us.

Now I am going to ask Chairman Dorgan to continue with this hearing, and I appreciate his cooperation.

One reason I am leaving is, I have with me here today, Mr. Edward Heath, an engineer from California. He and I were freshmen at the University of Texas back in 1932. That goes back almost as long as Claude Pepper can recall, and we are going to have lunch and revisit some of our freshmen and university days.

So I am going to take my leave now, but I wanted to tell you that I appreciate your testimony. We will be following through on this and working with you in every way we can.

Mr. TOBIAS. Thank you very much, Mr. Chairman. I appreciate it, and we also appreciate your interest, particularly at the Austin Service Center. It has been very, very helpful.

Chairman PICKLE. Thank you. Well, we have got a good group there. Thank you.

Mr. TOBIAS. We were also able to estimate, based on the IRS budget justification in 1990, a loss of $2 billion in revenue because of decreased funding in 1989, and we estimate an additional $200 million loss in 1989 due to the scaled-down service center compliance operations.

And finally, we have just been told, within the last week, that the Internal Revenue Service is now looking at the viable possibility of conducting reduction in force in the Internal Revenue Service, in light of its shortfall in funds for 1989.

Approving a supplemental of $204 million will have the impact of restoring, now, restoring today, what the administration asks to be restored in its 1990 budget.

The fiscal year 1990 acknowledges the need to restore the cuts in service center examinations and collection operations. We ask that the cuts be restored today, and we suggest that based on the administration's own numbers, it will yield $1 billion in funds collected.

So for an investment of $204 million, $1 billion can be recovered. Similarly, in 1990, President Reagan's budget proposes an increase of 5,000 positions over 1989.

However, if President Bush's flexible freeze is applied to IRS, and IRS is held to the same dollar level in 1990 as in 1989, it would be necessary to cut some 5,000 positions from the 1990 budget request, resulting in some $700 million in lost revenue.

We note that President Bush is taking credit for $3 billion in revenue over 5 years, and therefore implicitly says the IRS is not subject to a freeze because you cannot have the revenue without the people needed to collect it, but of course this is very unclear at this time.

President Reagan's budget is really full of some sleight-of-hand maneuvers, as we see it. The President stated the IRS needs an additional 5,000 persons, and $488 million to maintain current services and cover the increased program needs, but then, what he giveth with the left hand he taketh away with the right hand, and says that there is—he cuts $111 million out of the ADP operations and claims some savings from contracting out.

And then, instead of proposing $488 million, proposes $289 million, or $200 million less than he says he actually needs. I think this is very shortsighted, very pennywise and poundfoolish.

There is nobody going to save $111 million by further reducing the ADP budget.

NTEU suggests an alternative budget in table II of our testimony which would fully fund the sham savings in the Reagan budget and slightly increase the already acknowledged need for a revenue initiative.

And we have prepared some charts, Mr. Dorgan, that I think might make clear where we are. The first chart is an overall chart of the Internal Revenue Service and it shows that NTEU is suggesting, at the bottom, some additional—some 6,446 more positions in 1990 which are necessary to process the 3.5 million additional returns over 1989.

These positions will yield $1.8 billion in 1990 and $10.2 billion over 5 years. Now in contrast, the Internal Revenue Service is pro-

jecting a reduction of 1,800 positions from 1988 to 1989, even though the number of returns has increased by 4.8 million.

And I might note that there is a distinction between our use of 147.7 million returns, and that used by Commissioner Murphy—or Acting Commissioner Murphy, of 196 million returns.

We focus on the primary returns filed—the individuals, corporate, partnership, estate and gifts, and employment tax. Those are the real returns that generate revenue and yield.

In the returns processing area, in 1990 IRS proposes to increase returns processing by 1,575 positions and NTEU proposes an increase of 2,750 positions. The IRS proposal is based solely on restoring in 1990 what was eliminated from the 1989 budget. But we believe that with the increased number of returns and no real apparent savings from any simplification of tax returns, it would be very unwise not to hire 1,200 more people to process 3.5 million more returns.

Now as Chairman Pickle said about taxpayer service, Commissioner Gibbs has done a very excellent job in restoring taxpayer service and providing service to the public. Just a few short years ago the IRS was proposing that taxpayer service be eliminated. IRS projects that it will have to answer about 46 million phone calls in 1990 to maintain an 85-percent answer rate. It assumes that even though there are more taxpayers filing more returns, fewer taxpayers will be requesting assistance since 46 million requested assistance this year.

I believe the projections are wrong. With more taxpayers there will be more questions asked. I also believe we should have a 90 percent, not an 85 percent answer rate. That would require 8,800 additional people in taxpayer service. The difference, of course, between a 90 and an 85 percent answer rate is about 5 million more calls answered. So we are not talking about just a few people when we talk about increasing that response rate.

In the examination area, the 1988 current audit coverage is 1 percent with 1.2 million returns to be audited. It is the absolute lowest audit coverage in the history of the Internal Revenue Service. You can see beginning in 1985 how the number of returns has declined. Of course, with the increased number of returns filed, the percentage of coverage has fallen dramatically.

IRS projects it can increase audit coverage to 1.1 percent by auditing 1.4 million returns in 1989. Now how it is going to do this with 858 fewer employees than it had in 1989 is a mystery to me. Then it projects coverage of 1.2 percent in 1990 by further decreasing its staff by 216 employees. In short, the IRS is suggesting that it can audit 300,000 more returns in 1990 than in 1988 with 1,074 fewer people. I think that is smoke and mirrors. I do not think this can be done.

NTEU proposes to increase audit coverage by 1.3 percent by adding 2,483 positions. This will lead to additional assessments of $672 million in 1990 and $416 of the $672 million will actually be collected in 1990.

Similarly, in the collection area we have, if you look at these numbers, current accounts receivable of $56 billion. But the number of tax delinquent accounts in 1985 was 1.7 million. The

IRS is projecting, and allowing, and thinking it is OK, that we will have 3.5 million tax delinquent accounts in 1990.

NTEU proposes to add 2,380 positions to the IRS request to keep the number of TDA's at 3.2 million, the same as last year. This would allow 254,000 TDA's to be collected, and 227,000 TDI's to be closed, and $1.4 billion additional revenue collected.

Mr. Chairman, in addition to the staff requests, NTEU suggests some fundamental changes to deal with the turnover and other problems. First, we acknowledge that the pay gap will not be eliminated any time soon. Therefore, the IRS must be given additional tools to attract the employees it needs. For example, we suggest that the IRS invest heavily in training in the professional development of employees. NTEU believes that many workers would stay longer if there was a clear path of professional development. Completion of training could be linked to an agreement to remain with the IRS for a fixed period of time.

We also believe that the classifications have to be changed. We agree with the GAO and the Hudson Institute who acknowledge that more flexibility must be placed with the agency heads. We support the Commissioner of the Internal Revenue Service having independent personnel authority. We also believe that the initial hiring rates have to be increased.

We urge this committee to bring to the attention of the budget negotiators and the Appropriations Committee that a modest increase in the IRS work force will yield much more than that expended. There is no reason to forgo the collection of revenues to which the Government is legally entitled when the need is so great.

Thank you very much, Mr. Chairman.

[The statement and attachments of Mr. Tobias follow:]

STATEMENT
OF
ROBERT M. TOBIAS
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

Mr. Chairman and Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union. NTEU is the exclusive representative of over 144,000 Federal workers, including virtually all employees of the Internal Revenue Service. I am accompanied today by Patrick Smith, NTEU Director of Legislation, and Paul Suplizio, legislative consultant.

On behalf of the men and women who collect the revenue of the Federal government, I am pleased to appear before you to present our Union's recommendations on the urgent need for supplemental funding for IRS in FY 1989 and the Administration's budget request for FY 1990.

First, let me summarize briefly the immense challenges confronting IRS in the decade ahead and the fundamental changes we think are required. Our growing population is generating millions of new tax returns to process each filing season. Frequent tax law changes are making returns processing, taxpayer service, and enforcement more complex and difficult. Voluntary compliance is stuck around 82 percent as much of the public flirts with non-compliance. An opinion survey commissioned by IRS in 1984 found that 55 percent of taxpayers strongly support rationales for non-compliance, while 37 percent actively seek ways to "beat the system." The tax gap will hit $113 billion by 1992, and there is an additional tax gap of $56 billion in uncollected accounts receivable. If we had 90 percent compliance, that is, if 90 percent of the taxes legally due were voluntarily paid, $72 billion a year more would flow to the Treasury. We aren't collecting this money because audit coverage hovers around 1 percent and there are too few revenue officers to work 3.2 million backlogged delinquent accounts--the largest number in history. IRS' ability to do its job is obstructed by two big resource gaps--a computer gap and a skills gap. The computer gap is better known: the Service has been spending one dollar out of every five on automation in recent years, but it still takes 2-6 weeks to retrieve a taxpayer's return from the files, and the mainframe computers will run out of capacity by 1995. IRS' skills gap is even more important, as inadequate pay, training and career opportunities are severely limiting the Service's ability to recruit and retain competent people. The result, amply documented by GAO, is that IRS' reputation for efficiency and service is being badly tarnished by excessive errors in returns processing, inaccurate and incomplete correspondence, and too many wrong answers over the toll-free telephone system.

In sum, our system of tax administration is being worn down, and it's wearing away faster each year. Throwing money at the current system is not the answer, rather, fundamental changes are required in how IRS does its job, the image it presents to the nation, and how it manages its human resources to sustain a highly-skilled, professional work force. IRS must shed its factory image of a system that processes, examines, and collects by rote millions of returns and where the emphasis is on production. Today's varied tax laws require custom treatment of a taxpayer's account akin to the services offered by financial institutions. Being able to deliver responsive tax accounting will require a skilled workforce operating in an

automated environment where the emphasis is on quality service to the customer. IRS needs to press ahead with office automation, but the object shouldn't be to replace the current machine with a more efficient one; rather, we need a system in touch with the needs and attitudes of its customers and oriented to respond with quality service. Instead of processing caseloads, this system would process a two-way flow of communication between taxpayers and IRS employees, who would have access to the information needed to respond efficiently to compliant taxpayers, as well as taking enforcement action against the non-compliant.

NTEU has deliberated at length about the requirements for attracting and retaining a competent workforce capable of performing the increasingly technical work of IRS' many occupations. We are convinced that most of the position classifications and pay grades for today's occupations are obsolete, having been outstripped by advancing technology. GAO's work has repeatedly demonstrated the uncompetitiveness of government pay at the entry-level grades established for critical IRS occupations. As the Hudson Institute's Civil Service 2000 report reminds us, government agencies will have to compete in an increasingly tighter marketplace for the skills they need. Consequently, we support legislation granting the Commissioner fully independent personnel authority, so IRS can compete in the marketplace for the calibre of people it needs by paying competitive salaries. Such action will be difficult to achieve, but we are convinced that it must inevitably occur if our Federal agencies are to remain viable, and we urge this Subcommittee, as a matter of the highest priority, to begin the legislative process leading to independent personnel authority for IRS. We repeat our call for Congress to authorize retention pay for critical occupations so IRS employees can earn the same as private sector employees with comparable skills. We support direct hire authority in appropriate cases, as well as a full comparability pay increase for Federal workers.

Fundamental change is required to make the Service a more attractive place to work and pursue a career. This can be done by first, investing heavily in training of the workforce; second, providing opportunities for professional development in specialties the Service needs; and third, establishing choice of career opportunities as a basic program for IRS workers. There are two ways IRS can obtain the skills it needs: by hiring new workers in the marketplace, and by training its on-board employees. IRS is already experiencing significant training costs from high turnover followed by new hiring in the marketplace. This training doesn't contribute to retention because it's simply part of the hiring cycle. NTEU believes many workers would be motivated to remain with the Service if they saw a career path filled with progressive opportunities for more advanced training at government expense. Completion of this training could be linked to an agreement to remain with IRS for a specific period. To implement this idea, IRS would have to become a school of tax law and technical learning, sponsoring in-house training and civil schooling appropriate to the specialties the Service requires. It would also haveto develop career patterns showing how a progression of training and assignments leads to professional development

in a chosen specialty. The Service should then announce a worker retention program that promises to grant employees, within service needs and provided a vacancy is available, (1) their choice of specialty or occupation, (2) their choice of training, and (3) their choice of assignment location, provided they remain with the Service for a specified period. IRS's size, its many locations, and its diverse activities and skills would make it possible for such a program to succeed. A choice of career opportunities would be a powerful retention incentive. We urge the Subcommittee to support this program and authorize a significant augmentation of the IRS training base to develop the skills its future will depend on.

FY 1989 Budget Situation

IRS is in a budgetary crisis this year due to OMB's requirement that the agency absorb over $200 million in uncontrollable costs for the 4 percent Federal pay raise, retirement, postage, and health insurance, as well as necessary costs for congressionally-mandated improvements in Combined Annual Wage Reporting and taxpayer assistance. As a result, IRS is living off the shelf for consummable supplies, and many items like paper clips and computer paper are in short supply. Travel and training have been curtailed, broken equipment isn't being repaired, and furniture and office equipment isn't being purchased. A hiring freeze is in effect for all but Taxpayer Service and Returns Processing. Because attrition has fallen, more permanent employees are on board than anticipated, and many are being used outside their specialties to plug gaps in Returns Processing and Taxpayer Service. To avoid a repetition of the 1985 filing season, resources have been reprogrammed from administrative support and compliance functions to process tax returns and operate the toll-free telephone system. The Service Center compliance branches for Examination and Collection, who perform correspondence audits and follow up underreporter and non-filer leads, have had their temporary workforce decimated. Last year, Service Centers had 1,152 temporaries on board in Examination branches, this year the number is 555. Last year, Service Center Collection branches had 914 temporaries, this year they have only 470. Three Service Centers--Andover, Memphis, and Atlanta--have lost permanent workers in either Examination or Collection, with Andover experiencing the biggest loss. Andover has also had a drop in total employment, from 4,590 to 4,296, in the past year.

According to the FY 1990 Budget Justification, IRS will collect $2 billion less in direct enforcement revenue than originally planned for FY 1989 (See Table 3). With the year half gone, $1 billion of that amount is already irretrievably lost. The remaining $1 billion can be recovered if the Subcommittee will move immediately to support an emergency supplemental appropriation for $205 million to make up this year's required cost absorptions and restore IRS' Service Center compliance programs. The two billion revenue loss is due to the scaled-down program forFY 1989, not just to the hiring freeze. We estimate the amount associated with the hiring freeze to be $200 million, because that is what Service Center compliance operations would collect if they had staff-years equivalent to a full

complement of workers, including temporaries. The FY 1990 budget restores to Examination and Collection about the same number of staff-years as were lost among temporaries this year due to the hiring freeze. IRS estimates in the budget that restoring these positions will bring in $208 million, so we believe our estimate of $200 million for the cost of the hiring freeze to be accurate.

To set events in perspective, you will recall that a year ago the Commissioner told this Subcommittee that IRS had requested of Treasury and OMB an additional $870 million and 13,000 average positions for FY 1989. In the opinion of IRS's leadership as well as former commissioners and competent professionals, that was the minimum needed to make improvements in taxpayer service and returns processing, while strengthening enforcement to collect $3.3 billion in FY 1989 and 1990. That request was disapproved on grounds it could not be accommodated within the terms of the bipartisan summit agreement, despite the fact that the Federal government desperately needed the $3 billion in revenue. The first lesson of the 1989 experience is that the revenue-producing agencies of the Federal government must be treated differently from other agencies in taking any deficit-reduction actions. They should be treated differently because they <u>are</u> different: they are revenue-producing, and cuts simply lose revenue. In view of the current budget negotiations, we strongly recommend, Mr. Chairman, that you write the Speaker and Chairman of the Budget Committee to remind them of this important point. The Chairman of the Ways and Means Committee should use the full authority of his position to insist on an exemption for IRS and Customs from any arbitrary budget ceilings. Their ceiling should be set based on the amount of revenue to be collected in accordance with the budget agreement. We must not have a repetition of a budget summit agreement leading to a spending collapse in the arm of government charged with collecting revenue.

Not long after Congress passed the Treasury appropriations bill last year, IRS determined that it would start FY 1989 with a $360 million shortfall, consisting of a $105 million reduction in its budget request, $85 million for congressionally-mandated improvements in taxpayer service, and $170 million in pay and other uncontrollable costs including Federal retirement and health programs. A request to OMB for a supplemental appropriation was disapproved, so IRS then made a conscious decision to reprogram funds into Taxpayer Service and Returns Processing. The 1985 experience casts a long shadow over IRS. Management understands the need to respond to taxpayers and have a successful filing season. But this year the cost of the filing season is being borne by administrative support and compliance programs. A glance at Table 1 shows that $133 million was absorbed to meet the pay raise and associated health and retirement costs. Another $56 million was reprogrammed to maintain Taxpayer Service at 8,400 FTErather than 7,100 FTE in the budget. This is considered essential to sustain an 85 percent level of service (answering 85 percent of taxpayer calls), upgrade the tax assistor workforce, and improve accuracy. A further $15.9 million has gone to Returns Processing, to improve correspondence with taxpayers and to reconcile discrepancies

in earnings reported by employers to IRS and SSA under the Combined Annual Wage Reporting system. When employers report less to IRS then they do to SSA, additional employment taxes may be due; when they report more, workers' retirement accounts may require crediting with additional earnings. Congress has taken a strong interest in this effort, the programs are underway, and resources are being applied. The funds are coming from the hiring freeze and reprogramming administrative support and compliance monies.

It's important to note that the programs being cut are recognized as essential in the 1990 budget (Table 2). Service Center Examination and Collection branches are both slated for increases next year, in effect restoring the cuts they have absorbed. OMB has also agreed to allow $82 million of the $114 million pay requirement for next year, thus acknowledging the need for a pay supplemental today. By approving a supplemental, Congress can relieve the hiring freeze and make the administrative support and compliance programs whole again. The Treasury will gain an additional $1 billion in the process, as we show in Table 3. We urge the Subcommittee to urgently undertake this task, for what is happening this year is simply no way to deal with an agency as important to the nation as IRS.

FY 1990 Budget Request

President Bush's budget puts IRS into the box of discretionary programs subject to a "flexible freeze". We would like to reiterate our view that treating the nation's revenue-producing agencies like other agencies for budget purposes is a big mistake. If IRS were held to the same dollar level as last year under the freeze, we estimate that $289 million and 5,000 positions would have to be cut from the FY 1990 budget, resulting in $700 million in lost revenue that year. This includes $318 million from 1,360 new positions included in the budget for a modest revenue initiative (Table 6). In President Bush's budget, OMB has seen fit to take credit for this new revenue, which amounts to $3 billion over five years. This would imply that IRS should never have been made part of the freeze in the first place, because collecting this revenue depends on a budget increase. The Congressional Budget Office has reviewed the IRS revenue initiative and agrees that $318 million would be collected in FY 1990 and $3 billion during FY 1990-1994. We anticipate that the budget negotiators will include this revenue in any final package, and we would like to demonstrate how billions more can be obtained by expanding the size of the revenue initiative to increase audit coverage and collect more taxpayer delinquent accounts.

President Bush has proposed that Congress use President Reagan's budget request for IRS as the basis for discussion of options. In NTEU's view, the Reagan budget iswoefully deficient and should be rejected out of hand. If approved, it would stop work on 25 separate automation projects, including the Treasury-wide Payroll System, Automated Financial System, Human Resources Planning System, Automated Examination System, Integrated Collection System, W-4 Data Base, Automated Underreporter Program, Examination Inventory Control System, and several other important projects on which millions have already been spent. IRS

employees have a stake in many of these projects, such as the Automated Examination System which is designed to significantly increase Revenue Agent productivity, and the Treasury-wide Payroll System which is important to every worker who draws a paycheck, because the present obsolete and error-prone system is harming morale and needs to be replaced as soon as possible. At the same time that IRS is proposing to remove these projects, totaling $111 million, from its budget base, it is proposing to spend an additional $102 million on other ADP modernization programs. Given the importance of modernization to the future of the Service, it is NTEU's view that both the eliminated projects and the new ones are required, and the cancellations are simply a budgetary gimmick to give the appearance of lowering costs by $111 million. The eliminated projects will undoubtedly reappear in future budgets, but in the meantime IRS' modernization would be set back and contract cancellation costs would be incurred. We believe that all the ADP projects cut from the Reagan budget should be allowed to proceed, and NTEU's alternative budget restores $111 million in funding for these projects.

Table 2 presents President Reagan's budget request for FY 1990 and NTEU's alternative proposal. We show the increases contained in the budget for new programs and to maintain current service levels. The new programs are the revenue initiative to collect additional taxes, ADP modernization, and several actions to improve responsiveness to taxpayers. We do not dispute the increases called for, which total $488 million and 5,081 average positions. We simply maintain that they should be fully-funded, and they are not. Besides the cut of $111 million and 728 FTE from ADP programs, there are claimed savings of $11 million and 231 FTE from completion of Tax Reform, and $13 million and 1,487 FTE from A-76 studies. We believe it is unrealistic to expect such savings to occur. The process of digesting Tax Reform has just begun, and if any savings are achieved, they should be redirected to other Tax Reform workloads. As we make clear later in our statement, the claimed savings from A-76 studies are often specious, and these studies have seldom been exposed to public view. GAO's work in this area supports the view that these studies seldom lead to any savings and may end up costing the taxpayer money. Consequently, our alternative budget restores these cuts as well as funds for deleted ADP projects, a total of $135 million and 2,446 FTE (see Table 4). This amount is the minimum needed to fully fund the Reagan budget and carry out the programs it contains.

We believe the revenue initiative contained in the budget is too small, considering the nation's revenue needs and the potential ability of IRS to generate larger sums from both direct enforcement and improved voluntary compliance. More than $17 billion can be collected from the growing inventory of taxpayer delinquent accounts. The backlog of these accounts well rise by 400,000 this year to 3.2 million, and increase further to 3.5 million by the end of FY 1990 if the Reagan budget is approved. The Reagan budget does not allow IRS sufficient staff to collect these delinquent accounts or to increase audit coverage above 2 percent. According to the budget, each examination yields an average of $13,500. So the prospect of raising large

sums from a modest increases in IRS compliance resources is real, and we recommend that the Subcommittee bring this point to the attention of congressional budget negotiators as a matter of the highest priority, for there is no reason to forego the collection of revenues to which the government is legally entitled when the need is so great. Collection of these sums is a matter of simple justice, since the vast majority of taxpayers paid their fair share voluntarily.

Recalling that last year the Commissioner informed this Subcommittee that IRS could collect $1.1 billion in the first year of a new revenue initiative employing 6,800 positions, it is clear that IRS can do better than the 1,360 positions to collect $318 million that the 1990 initiative calls for. In fact, a good part of the initiative consists of restoring temporary positions in Service Center compliance branches that were eliminated this year. In that sense, the 476 staff-years to increase correspondence audits and collect $101 million isn't new at all, it it only work that has been deferred. Consequently, NTEU's alternative budget adds 2,000 positions for Examination and 2,000 for Collection for a larger revenue initiative costing $182 million. NTEU has estimated that an increase of 2,000 FTE in Examination would permit IRS to examine 200,000 more returns, raising audit coverage from 1.2 to 1.3 percent, and assessing additional taxes and penalties of $672 million in FY 1990. Of this amount, $416 million would be collected that year. We estimate that 2,000 FTE in Collection would allow the Service to collect 254,000 more taxpayer delinquent accounts and close 227,000 more taxpayer delinquent returns investigations, returning $1.4 billion annually to the Treasury. A summary of the cost and revenue yield for NTEU's expanded revenue initiative is presented in Table 5. All told, the 4,000 additional positions would collect $1.8 billion in FY 1990 and $10.2 billion over five years. This brings NTEU's total recommended additions to the Reagan budget to $318 million and 6,440 average positions (Table 4). Our budget recommendation for FY 1990 totals $5.8 billion and 121,556 average positions, and we urge the Subcommittee to support this budget with the funding increases we have called for, that is, $318 million and 6,400 average positions.

Revenue Officer 20-Year Retirement

Revenue Officers, charged with taking collection action against taxpayers when all else fails, have one of the most hazardous and stressful jobs in the Federal service. Many taxpayers personalize their failure to comply with the tax laws; they see the Revenue Officer as a threat to their way of life. Many persons subject to collection action are involved with drug dealing and other criminal activities. Some belong to organized tax protest movements, who make Revenue Officers the butt of activities such as threatening phone calls, vandalism, confrontation with weapons, and filing baseless liens against the officer's property. Revenue Officers have been attacked by dogs, hit by cars, threatened with shotguns and handguns, and murdered in line of duty. A Revenue Officer in Buffalo was shot and killed while making a field call; another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer

during a meeting at an IRS office. Some officers have been placed under protective surveillance because contracts were let on their lives. Verbal abuse and threatening phone calls are commonplace, as officers and their families are regularly sworn at and branded as public enemies. Overall, the number of assault and threat incidents against IRS employees rose from approximately 400 in 1981 to 988 in 1985, a 147 percent increase. Revenue Officers are the subject of 77 percent of these incidents, more than half of which are physical assaults, despite the fact that they comprise only 8 percent of the IRS workforce. More than 77 percent of assaults, and 79 percent of threats with deadly weapons, are committed against Revenue Officers. Revenue Officers, who work the most complex and difficult cases, have excessive caseloads that frequently average more than 100 at a time, and this pressure keeps individuals from taking proper steps to protect themselves.

The potential that confrontation with a taxpayer will erupt into violence adds a constant element of stress and danger to the Revenue Officer's job, and there is ample scientific evidence of the consequences--high blood pressure, stomach problems, sleeplessness, suicide, and eventual disability. Research commissioned by IRS confirms that everyday stress and danger ultimately exacts a physical and mental toll on older, longer-tenured, officers. Younger officers are better able to cope with the everyday stress, and are physically and emotionally more resilient. NTEU believes there is a strong public interest in maintaining a youthful and vigorous corps of Revenue Officers, and that the proper way to achieve this goal is to permit retirement after 20 years under the provisions of Title 5, U.S.C. 8336(c)(1). Legislation to accomplish this has been introduced in the House by Congressman Al Swift (H.R. 1083) and in the Senate by Senator Barbara Mikulski (S. 513), and we strongly urge the Subcommittee to endorse this important legislation. It is the single most important step this Subcommittee can take to achieve a strong and effective collection arm in the face of mounting challenges to our tax system by a part of the citizenry who are openly contemptuous of it. If this were not so, why are there $56 billion in unpaid taxes and a rapidly growing number of delinquent accounts? We believe the legislation we have proposed will more than pay for itself through reduced attrition and training costs, and greater productivity. A 1987 IRS study found that, while annuity payments would increase by almost $508,000 annually if 20-year retirement were allowed, training costs would be reduced by as much as $2 million annually and revenues collected increased by as much as $105 million annually. We understand these projections are tentative, but they demonstrate that only a small saving is required for our proposal to more than pay for itself.

Congressional Leadership Required to Improve Workforce Stability and Quality

Recent studies of IRS activities by GAO have consistently linked poor performance to high turnover among employees. In an August 1988 report on the ability of IRS Error Resolution staff in Service Centers to catch taxpayers' and IRS' own processing errors, GAO found 72 percent of the errors could have been fixed early if data

transcribers and error-resolution examiners had performed required double-checking. Most errors weren't found until a final check just before refunds on tax-due notices were to go out; those taxpayers got correct refunds or notices in 7-15 weeks instead of the usual 4-6 weeks. Other taxpayers got excessive refunds or bills. It costs 30 cents to fix an error during error-resolution processing, but $4.19 after a taxpayer gets an incorrect notice. GAO found that high turnover among Error Resolution examiners contributed to the large number of errors not being caught. At one Service Center, 57 percent of Error Resolution examiners were new hires, while at another 50 percent were new hires. New hires receive three weeks training, but managers believe they do not analyze and correct errors as effectively as more experienced examiners. The source of the turnover was the inadequate grade established for the position, so more experienced examiners were leaving for promotion elsewhere. A higher pay grade would attract and retain the experienced employees needed in these units.

In a July 1988 report on Service Center Correspondence branches, GAO found that in about half the cases IRS' adjustment action or reply to the taxpayer was incorrect, unresponsive, incomplete, or unclear. Thirty-one percent of the cases had critical problems involving incorrect adjustments and incorrect or unresponsive letters. Some managers said it was hard to retain tax examiners because new hires find the job more difficult than anticipated and opportunities for advancement beyond grade 7 are limited. Tax examiners are generally hired from outside IRS in grades 4 or 5, with a starting salary of $13-15,000. They are required to have knowledge of a broad range of tax regulations, the computerized master file system, and the effects of transactions on taxpayers' accounts. The minimum requirements to qualify as a grade 4 are generally two years of college and/or two years of clerical or office work. Clearly, the pay level and advancement opportunities for the tax examiner position are insufficient to retain a skilled staff in correspondence units.

The Civil Service 2000 report projects that the Federal government will face skill shortages for entry-level computer specialists while it is becoming increasingly dependent on information technology. The report advises the government to invest heavily in entry-level training for these specialists. In a February 1989 report, GAO found uncompetitive pay and limited training opportunities to be hindering Federal efforts to recruit and retain ADP personnel. GAO found the government's entry-level salary for a computer programmer to be as much as 33 percent less than private sector pay for similar work. The average Federal entry-level salary is $15,118 (grade 5) compared to $22,531 paid by the private sector. According to one commentator, "IRS has almost no chance of hiring computer science majors out of college." IRS' Recruitment and Turnover Study (1984) found government entry-level salaries for computer science majors with no experience to be 50 percent of private sector entry salaries. One IRS computer division had 213 employees, of whom only 4 held advanced degrees in information systems and only one held a bachelor's degree in computer science.

Service Centers are finding it increasingly difficult to attract and retain experienced employees. Whereas 55 percent of seasonal employees at Service Centers had previous IRS experience in 1984, this number had dropped to 39 percent in 1987. In the past, many seasonal employees would return to the service centers from one year to the next, bringing their experience with them. This is no longer the case, due mainly, according to Service Center officials interviewed by GAO, to "lack of part-time work and flexible work hours at the centers, job stress due to performance standards, and entry level salaries that were often lower than those offered by local fast food restaurants." Inexperienced staff make more errors in returns processing. During the 1988 filing season, IRS attributed 36 percent of 3.2 million errors to mistakes made by processing staff, the bulk of them by data transcribers who code and edit returns. We agree with GAO's conclusion that "the benefits from converting seasonals to permanents or from any other steps that might be taken to stabilize the service center workforce are critical. Without such stability, IRS will find itself using more and more of its limited resources to avoid and/or correct errors caused by inexperience."

In the critical Revenue Agent occupation, IRS is increasingly unable to compete with the salary scales of the private sector in attracting college accounting graduates. In February 1987, starting salaries for college accounting graduates were $14,822-18,358 for IRS, $22,000-25,000 for "Big Eight" accounting firms, and $17,000-20,000 for other private sector accounting jobs. More than 90 percent of the offers made by private firms were above the Federal government's average offer. Revenue Agents hired in 1984 through 1987 on the average scored lower than 80 percent of private sector entry-level accountants on the AICPA Achievement Test. At the same time, experienced Revenue Agents are being siphoned off to better-paying jobs in the nation's accounting firms and corporate tax departments. One IRS study found that voluntary separations in grades GS-9 through GS-13 were 63 percent of the total number of Revenue Agent quits. Reacting to this turnover, tax professionals have increasingly commented to IRS on the problems created by a less experienced and trained field staff. A Revenue Agent study group in the Buffalo District reported that 51 percent of the agents and 53 percent of the managers did not consider training to be adequate in preparing agents in basic aspects of their job. To enhance quality and professionalism, the study group recommended that "management should actively encourage employee professional development by providing additional funding, time, and recognition for successful completion of CPA, MBA, legal, and accounting courses." Retention of persons with accounting backgrounds is a serious problem throughout the Federal Government. IRS' Finance Division has experienced turnover rates among accounting staff in excess of 25 percent for the last three years.

It is well known that, in the area of Taxpayer Service, high turnover has contributed to unacceptable error rates in the answers assistors give the public. Last year, the turnover in Taxpayer Service staff was 100 percent in Boston, 58 percent in Andover, and 39 percent in New York.

GAO recently commented that uncompetetive pay has made it difficult for IRS to attract and retain tax assistors, especially in larger metropolitan areas. Many of those hired either fail or drop out of training classes. In Los Angeles, 35 percent of those hired for a February 1989 training course dropped out or failed the course. IRS has upgraded the tax assistor position and is attempting to build a more stable workforce, but it remains to be seen whether it will be successful given the inadequate government pay scales.

The Comptroller General has commented, "You get what you pay for. Unfortunately, the Federal government's pay structure has broken down." The high turnover in IRS that is largely the consequence of inadequate pay is shown in Table 7, which presents attrition rates for permanent employees in 1984 and 1987. In the core occupations of Revenue Agent, Revenue Officer, and Tax Auditor, attrition rose across the board and is now in double digits. Servicewide, attrition remains above 11 percent. As a result, IRS is forced to spend millions to recruit and train new people--millions that could be better utilized to pay its experienced workers well and provide them attractive careers. A Revenue Agent, Revenue Officer, Taxpayer Service or Computer Specialist requires years of professional development. If IRS is unable to produce these professionals in large enough numbers, and if they continue to be siphoned off to better-paying jobs in the private sector, technical competence in the Service will suffer, the most advanced computer systems will be operated inadequately, taxpayers will not be able to get the quality of service they deserve, and the long-run health of the tax administration system will be undermined.

Earlier in our statement, we presented recommendations for actions deemed critical if IRS is to solve its recruitment and retention problems and develop a quality workforce for the future. We called for a substantial investment in training, which remains an orphan when it comes to budget priorities in the Service. A 1987 GAO survey of IRS employees showed that 57 percent believed their training on tax law changes was less than adequate. We proposed making IRS a learning center and using training, civil schooling, and choice of career opportunities as the basis for an effective retention program. We proposed the adoption of career choice as a fundamental policy, offering employees (consistent with Service needs and position vacancies) their choice of training, choice of assignment location, and choice of occupation or career path, contingent upon a commitment to continue in the service for a specified period. We urged the authorization of retention pay so IRS can keep its pay scales comparable to the private sector, and we proposed independent personnel authority for IRS. We believe these proposals are fundamental to an effective human resources policy to build the kind of Service the nation will need in the 21st century.

A-76 Studies

The FY 1990 budget requires IRS to achieve savings of $13 million and 1,487 staff-years through contracting out

work to the private sector, and the plan is for IRS to increase these savings to $84 million and 9,936 staff-years in FY 1994. The manner in which these savings are computed is explained in OMB's policy guidance as follows:

> "The savings projection is based on a formula that allows agencies, employees and taxpayers to share in the potential savings from this program. Since 1981, agencies have achieved average savings of $9,666 per FTE studied and have reduced FTE at the rate of over 60 percent of the FTE studied. For purposes of deducting funds from the budget requests we first used a dollar reduction of $4,875 per FTE to be studied (50 percent of the potential). We reduced that number by 25 percent to $3,656 to provide funds for the agencies to reward employees for their productivity efforts, as specified in the Executive Order. The FTE reduction used is 43 percent of the agency's study goal. This is about 25 percent reduction from the average actual FTE reduction experience."

It is clear that anticipated A-76 savings are based upon an "agency study goal" which sets the number of FTE to be reviewed for contracting out. Based upon OMB's expectations that a percentage of the positions studied will be successfully contracted, resource savings are computed and deducted from the agency's budget. The process is based on two significant assumptions, the first being that the projects studied are practical and the second that the savings anticipated by OMB are realized. Concerning the first assumption, there is a question whether much of IRS's work can be contracted out due to the necessity of safeguarding confidential taxpayer information. Concerning the second assumption, GAO found (T-GGD-88-7) that Federal agencies, in total, have achieved less than one-third of OMB's goals for numbers of positions in activities studied in fiscal years 1984 through 1986. GAO reported that agencies have continuing problems implementing the process, such as precisely defining the requirements for needed services and accurately estimating potential costs. When all pertinent functions are not included in the work statment, both an inaccurate estimate of savings and a costly contract modification can result. For example, in 9 of 11 Navy contract functions reviewed in 1984, projected savings were not realized due to higher than estimated contract administration costs and modifications increasing the scope of work. GAO also pointed to the impact of A-76 studies on the morale and productivity of the Federal workforce:

> "Employees undergoing an A-76 study face uncertainties about their future, which can result in lowered morale and reduced productivity. The process creates anxiety about whether the activity will remain in-house or be performed by a contractor. Employees generally recognize that a decision to contract out may mean a significant career move, or precipitate a change in pay status."

It is also true that A-76 studies are often biased because the savings reported are simply savings from not paying the costs of the benefits mandated for Federal workers. GAO found that in many cases Federal workers whose jobs were contracted out wound up working for the winning contractor without retirement, health insurance, or other benefits.

The process for conducting an A-76 study is supposed to allow affected parties an adequate opportunity to express their views. We have found this seldom to be the case, due to lack of sufficient notice from the agency at the front end of the process, when the A-76 study is assigned and undertaken. The procedure is that once a targeted activity is scheduled for an A-76 study, the government's requirements are to be precisely defined in a Performance Work Statement, or PWS. A management study is also conducted to determine the Most Efficient Organization (MEO) needed to accomplish the tasks in the PWS. The MEO is then to be used to develop the in-house cost estimate, which is to be subsequently compared to bids received from contractors, leading to a decision to remain in-house or to award a contract. Affected parties then can file an appeal to ensure that the decision is equitable and in accordance with A-76 procedures.

We believe the system should allow for greater participation of interested parties in this process. We urge the Subcommittee to include in legislation a requirement for notice to interested parties when A-76 studies are first assigned or undertaken, and publication of the study and all supporting documents at least 60 days before requesting proposals for contracting out an activity. Legislation should also allow Federal employees to challenge an agency's contracting out decision with the General Accounting Office.

Mr. Chairman, this completes my statement. I will be glad to answer any questions.

TABLE 1
Internal Revenue Service FY 1989 Budget Request, Appropriation, and NTEU Recommended Supplemental Appropriation
(Amounts in Thousands of Dollars)

	FY 1989 Request		FY 1989 Appropriation	FY 1989 Authorized Level		NTEU Recommended Supplemental Appropriation to Maintain Minimum Service Levels	
	Amount	FTE	Amount	Amount[1]	FTE[2]	Amount	FTE
Salaries & Expenses	94,547	1,630	87,165	87,542	1,608	+ 1,600	+ 58
Processing Tax Returns	1,850,134	36,175	1,740,353	1,763,110	35,874	+ 15,900a	+ 469
Examination and Appeals	1,864,819	42,412	1,932,441	1,868,801	42,172	+131,400b	+ 240
Investigation, Collection and Taxpayer Service	1,490,225	33,594	1,434,921	1,475,427	33,404	+ 55,882	+1,385
Collection Only	846,310	20,379		844,885	20,294	b	+ 85
Taxpayer Service Only	309,926	7,174		308,425	7,118	+ 55,882a	+1,300
TOTAL	5,299,725	113,811	5,194,880	5,194,880	113,058	+204,782c	+2,152

1. Within the total amount appropriated, $32,229,000 was transferred to Returns Processing and $41,754,000 to Investigation, Collection, and Taxpayer Service, while reducing Examination and Appeals a like amount, $73,983,000. Transfers were necessary to fund January 1989 pay, retirement, and health care cost increases, with Examination bearing virtually the entire $133 million total of such costs. In addition, Examination and Collection are absorbing costs totaling $71,782,000 for essential Returns Processing and Taxpayer Service programs that OMB would not provide funds for.

2. All areas except Returns Processing and Taxpayer Service are in a hiring freeze, positions are not filled as vacancies occur and savings are applied to offset a full-year funds shortfall of $360 million.

a. Adding these amounts restores 1,300 FTE for Taxpayer Service to maintain the FY 1988 level of 8,400 FTE, and 469 FTE for Returns Processing to implement combined annual wage reports (CAWR) matching and improve accuracy of correspondence with taxpayers. Because of continuing Taxpayer Service, CAWR, and correspondence problems, IRS is already using these resources and requiring Examination and Collection to absorb the costs. These resources are identical to additions requested for FY 1990, and NTEU is simply advancing their availability one year.

b. Additional funds totaling $71.8 million to be reprogrammed to Examination and Collection to offset absorptions noted in Note a.

c. Includes $85 million for 1989 pay raise, $23 million for increased health benefit costs, $25 million for Federal Employee Retirement System costs, $55.9 million for Taxpayer Service, and $15.9 million for Returns Processing.

TABLE 2

President Reagan's FY 1990 Budget Request for IRS and NTEU's Recommendation
(Amounts in Thousands of Dollars)

	(1) FY 1990 Request		(2) FY 1990 Request: Increases Necessary to Maintain Current Services and Program Increases[1]		(3) NTEU Recommended Additions to Restore ADP & Certain Other Cuts, & for Revenue Initiative[2]		(4) NTEU Recommended Appropriation	
	Amount	FTE	Amount	FTE	Amount	FTE	Amount	FTE
Salaries & Expenses	72,382	975	17,275	-625	+ 1,885	+ 8	74,267	983
Processing Tax Returns	1,940,640	37,449	276,349	3,070	+ 88,071	+1,175	2,028,711	38,624
Examination & Appeals	1,898,515	41,829	67,060	358	+124,748	+2,699	2,023,263	44,528
Investigation, Col. & T.S.	1,572,482	34,857	127,485	2,278	+103,339	+2,564	1,675,821	37,421
TOTAL	5,484,019	115,110	488,169	5,081	+318,043	+6,446	5,802,062	121,556

Notes:

1. These amounts are included within the FY 1990 request totals. They include additional resources required for workload growth and uncontrollable cost increases, such as the January 1989 pay raise. See pp. 3-4 of Budget Justification. Program increases include additional resources for a revenue initiative to collect additional taxes ($54,900 and 1,360 FTE), ADP and systems modernization (102,343 and 260 FTE), and to improve responsiveness to taxpayers (72,837 and 1,605 FTE). Total program increases are $230,080 and 3225 FTE. See p. 2 of Budget Justification.

2. The amounts shown in Columns 2 are recognized in the budget as essential additions to maintain current services and achieve program goals of collecting $3 billion in additional taxes over 5 years, continuing ADP and systems modernization, and improving responsiveness to taxpayers. However, these necessary increases are not fully funded. Instead, they are offset by a large reduction in ADP programs ($111,355 and 728 FTE) and by claimed savings from the A-76 program and implementation of the Tax Reform Act. NTEU's program restores these unwarranted reductions and thus fully funds the increases necessary for current services and program initiatives. NTEU then goes further and adds 4,000 positions for a compliance Revenue Initiative to collect $10 billion over 5 years. See Table 4 for details of NTEU's recommended additions.

TABLE 3

IRS Enforcement Revenue[1], FY 1988-1990

(Dollars in Millions)

	FY 1988 Actual	FY 1989 Requested Program[2]	FY 1989 Authorized Program[3]	FY 1989 NTEU Program[4]	FY 1990 Budget Request
Examination	21,100	21,200	20,500	20,800	21,700
Collection	31,066	35,400	34,100	34,800	35,876
Information Returns[5]	3,592	4,100	4,100	4,100	4,259
TOTAL	55,758	60,700	58,700	59,700	61,835

Notes:

1. Figures are additional dollars assessed in Examination and Information Returns programs, additional dollars collected in Collection program. Source is the IRS Budget Justification for FY 1990.

2. President's FY 1989 budget request, revised to reflect current Information Returns program yield forecast.

3. President's FY 1989 request was reduced by $105 million in FY 1989 Appropriation. Within that ceiling $63 million was transferred from Examination to Returns Processing and Taxpayer Service, thus reducing enforcement resources, and compliance programs had to absorb an additional $71 million in increased pay, retirment, and health care costs.

4. NTEU adds $205 million to fully fund the January 1989 pay raise, increased health care and Federal Employees Retirement System costs, and Returns Processing and Taxpayer Service program increases which OMB refused to fund and consequently had to be funded by reducing compliance programs (Examination and Collection). Funding these amounts will offset the reductions in compliance and make possible collection/assessment of $1 billion more than the currently authorized program for FY 1989. See Table 1.

5. Includes non-filer and underreporter assessments and penalties.

TABLE 4

IRS FY 1990 Budget: NTEU Recommended Additions to Restore Reductions
And For a Larger Revenue Initiative

	Total Amount Required to Restore ADP Reductions and Certain Othercuts[1]		NTEU Recommended Addition For A Larger Revenue Initiative[2]		NTEU Total Recommended Additions	
	Amount	FTE	Amount	FTE	Amount	FTE
Salaries & Expenses	+ 1,885	+ 8			+ 1,885	+ 8
Processing Tax Returns	+ 88,071	+1,175			+ 88,071	+1,175
Examination & Appeals	+ 32,690	+ 699	+ 92,058	+2,000	+124,748	+2,699
Investigation, Collection, & Taxpayer Service	+ 12,709	+ 564	+ 90,630	+2,000	+103,339	+2,564
TOTAL	+135,355	+2,446	+182,688	+4,000	+318,043	+6,446

Notes:

1. For complete lists of eliminated ADP programs, see pp. 3 & 5 of Budget Justification white pages. The reality is the programs are essential and there is no justification for eliminating their funding, other than OMB's requirement that IRS absorb a $111 million cut in ADP programs to pay for the ADP and other program increases in the budget. Certain other cuts refers to reductions made for completion of tax reform, and A-76 studies. NTEU believes IRS has not yet successfully completed tax reform, as evidenced by the high error rates in taxpayer correspondence and answering taxpayer questions. NTEU considers savings from A-76 studies unlikely, as such studies have not been exposed to public view and GAO has found the savings evaporate in many cases and end up costing the taxpayer money.

2. NTEU would add 2,000 positions to the 560 contained in the budget for an Examination Revenue Initiative, bringing total new positions for assessing additional taxes to 2,560--the same level recommended by OMB in the past, and the minimum necessary to keep audit coverage at a minimum level of 1.3 percent. NTEU also adds 2,000 positions to 497 in the budget for a Collection Revenue Initiative, bringing the total to 2,497 new positions--a little more than the successful FY 1983 Revenue Initiative of 2,300 positions. Inventories of taxpayer delinquent accounts and taxpayer delinquent returns investigations are rising sharply and will increase by 530,000 in 1990 under the Reagan Budget. A minimum of 2,000 additional positions are required just to keep TDA and TDI inventories at 1989 levels, which were the highest in history. For revenue yield of NTEU's recommended additions for Examination and Collection, see Table 5.

TABLE 5

Cost and Revenue Yield from NTEU's Recommended Larger Revenue Initiative

FY 1990-1994

	Additional FTE	Annual Cost (Millions)	5-year Cost (Millions)	FY 1990 Revenue Yield (Millions)[1]	5-year Revenue Yield 1990-1994 (Millions)	5-year Revenue Minus 5-year cost (Millions)
Examination	2,000	92	460	672a 416b	3,360	2,900
Collection	2,000	90.6	453	1,382c	6,910	6,457
TOTAL	4,000	182.6	913	1,798	10,270	9,357

Notes:

1. Derived by extending results of IRS Revenue yield models. For Examination, IRS claimed in last year's hearings that application of 2,500 FTE in FY 1989 would permit 244,000 more exams and $2.8 billion in assessments, with $347 million being collected the first year. For Collection, revenue yield is based upon IRS estimate that closure of 68,000 additional taxpayer delinquent accounts will yield revenue of $107 million in FY 1990. NTEU's revenue forecast is proportional to these results. We also used pp. 46-49 and 71-73 of the FY 1990 Budget Justification, and GAO's study of IRS revenue estimates (GGD 88-119).

a. Additional taxes and penalties assessed from 200,000 more examinations, raising audit coverage from 1.2 to 1.3 percent.

b. Revenue collected. Not all tax and penalty assessments are collected in the first year. Congressional Budget Office, Analysis of President Reagan's 1990 Budget, pp. 26 and 28, is an example of how receipts are spread over five years.

c. The two areas of collection where resources are urgently required because of sharply rising case inventories are collection of taxpayer delinquent accounts (TDA's) and delinquent returns investigations (TDI's). NTEU's program adds 1,500 FTE for TDA's and 500 FTE for TDI's, resulting in 254,000 more TDA accounts collected and 227,000 more TDI cases closed. The additional yield is $400 million from TDA's and $982 million from TDI's, a total of $1,382 million annually.

TABLE 6

IRS Revenue Initiatives Contained in FY 1990 Budget

Program	FTE	Estimated Additional Revenue Collected in FY 1990 (Millions)
Collection of Unpaid Taxes[1]	529	107
Reconciling Wage Reports[2]	225	69
Monitoring Dependency Compliance[3]	47	12
Increase Service Center Correspondence Audits[4]	476	101
Insuring International Compliance[5]	83	29
TOTAL	1,360	318

1. Resources requested will permit collection of 68,000 more taxpayer delinquent accounts (TDA's).

2. Resources requested will increase compliance in wage reporting by reconciling wages reported on employment tax returns and wages reported to Social Security Administration. An additional 332,000 cases would be worked.

3. The social security number of anyone claimed as a dependent must now be reported. IRS will monitor the use of SSN's to claim exemptions to guard against erroneous or fraudulent claims.

4. Resources requested will permit Service Center Examination branches to contact 188,000 additional taxpayers and assess additional taxes, penalties and interest. Collections from these assessments are estimated to be $101 million in FY 1990.

5. Resources requested will allow expansion of international exams with emphasis on large case corporations, closing additional delinquent returns cases, identifying overseas non-filers, and handling larger "double-tax" case workload stemming from Tax Reform Act of 1986.

TABLE 7

INTERNAL REVENUE SERVICE
Employment History
Selected Occupations
(FTE Positions)
President Reagan's Budget

Fiscal Year	Revenue Agents	Tax Auditors	Revenue Officers	Special Agents	Appeals Officers
1981 Actual	13,272	4,079	5,323	2,751	836
1982 Actual	13,554	3,888	6,028	2,685	821
1983 Actual	13,613	3,821	7,301	2,593	891
1984 Actual	13,442	3,474	7,531	2,790	1,031
1985 Actual	13,598	3,536	7,397	2,821	1,050
1986 Actual	13,658	3,317	7,266	2,800	1,662
1987 Actual	15,036	3,184	7,340	2,728	1,167
1988 Actual	16,720	3,310	8,340	2,890	1,291
1989 Estimated	16,796	3,586	9,226	2,880	1,588
1990 Estimated	16,663	3,586	9,305	2,880 *	1,588
Change					
Number					
90 over 89	(133)		79		
90 over 81	3,391	(493)	3,982	129	753
Percent					
90 over 89	-0.79%		0.86%		
90 over 81	25.55%	-12.09%	74.81%	4.69%	90.18%

* Includes 215 special agents financed by the Organized Crime Drug Enforcement task forces under the Department of Justice

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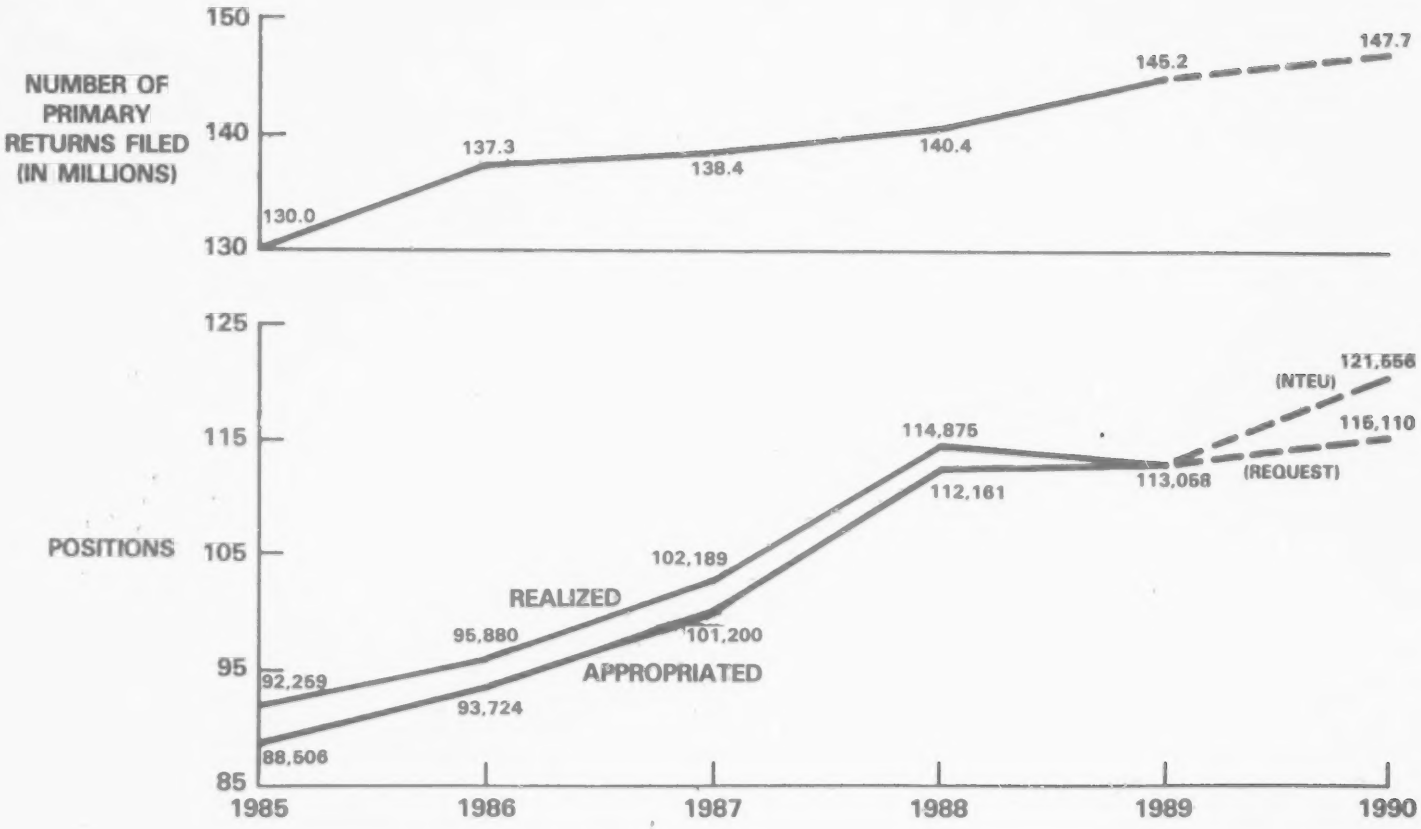
TABLE 8

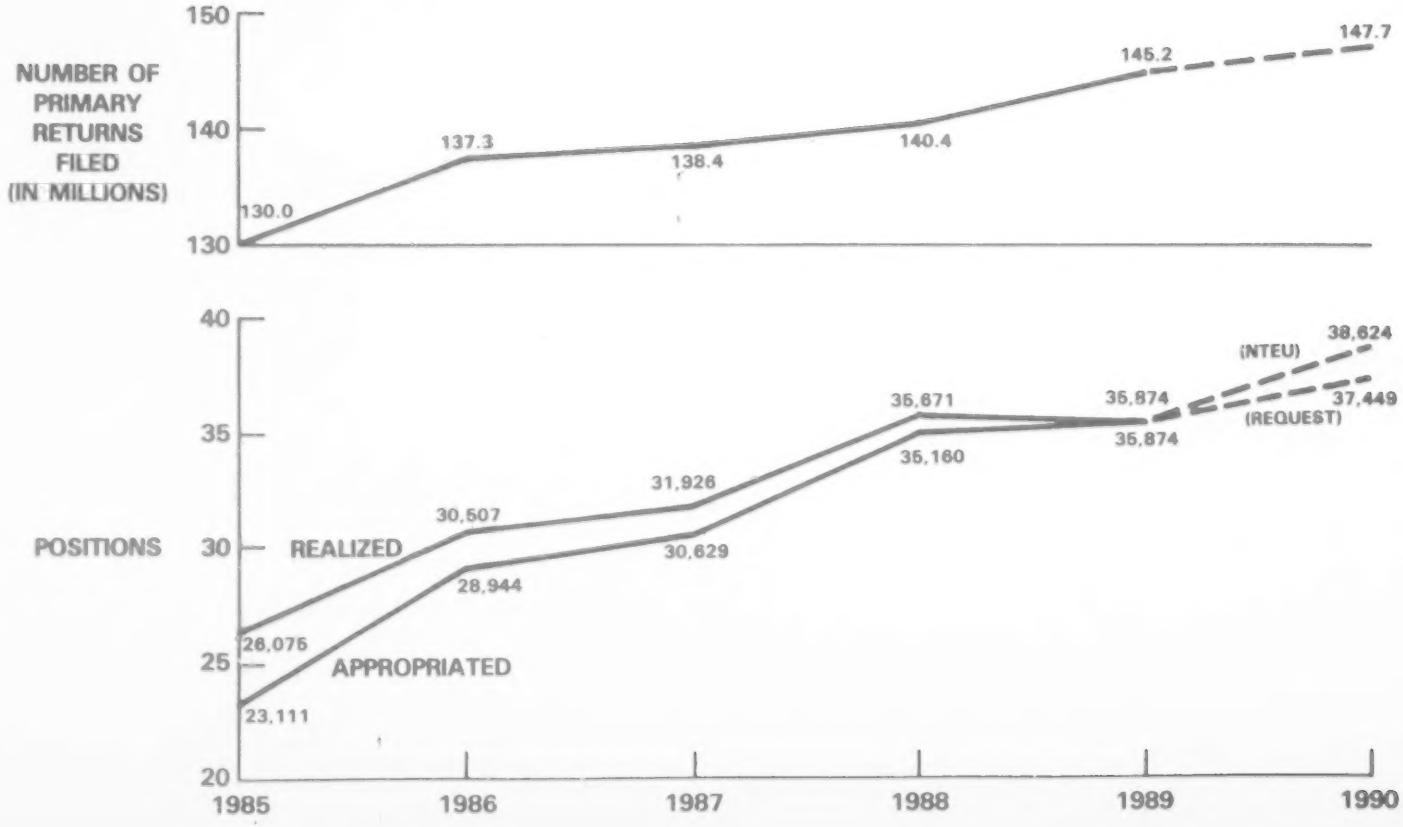
IRS Attrition Rates for
Permanent Employees, 1984 and 1987
(in percent)

	1984	1987
Servicewide	11.3	11.5
Revenue Agents	7.4	12.0
Revenue Officers	8.3	11.0
Tax Auditors	9.3	14.0
Special Agents		13.0
Regions		
Southeast	12.5	10.0
Midwest	10.4	9.0
Central	8.2	10.0
Southwest	14.0	11.0
North Atlantic	10.5	15.0
Mid Atlantic	14.6	12.0
Western	10.7	11.0
***		
National Office	9.8	11.0

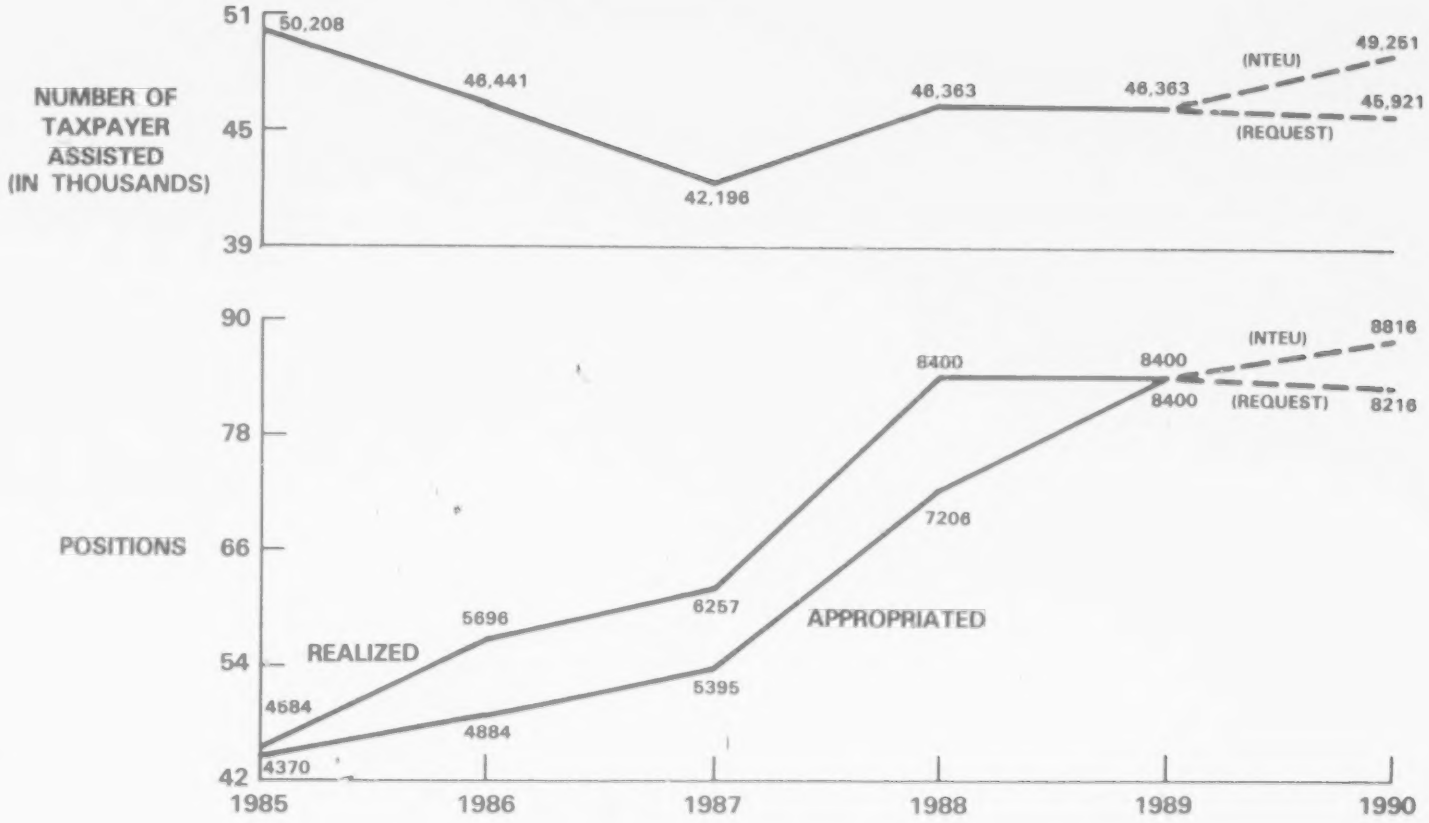
INTERNAL REVENUE SERVICE



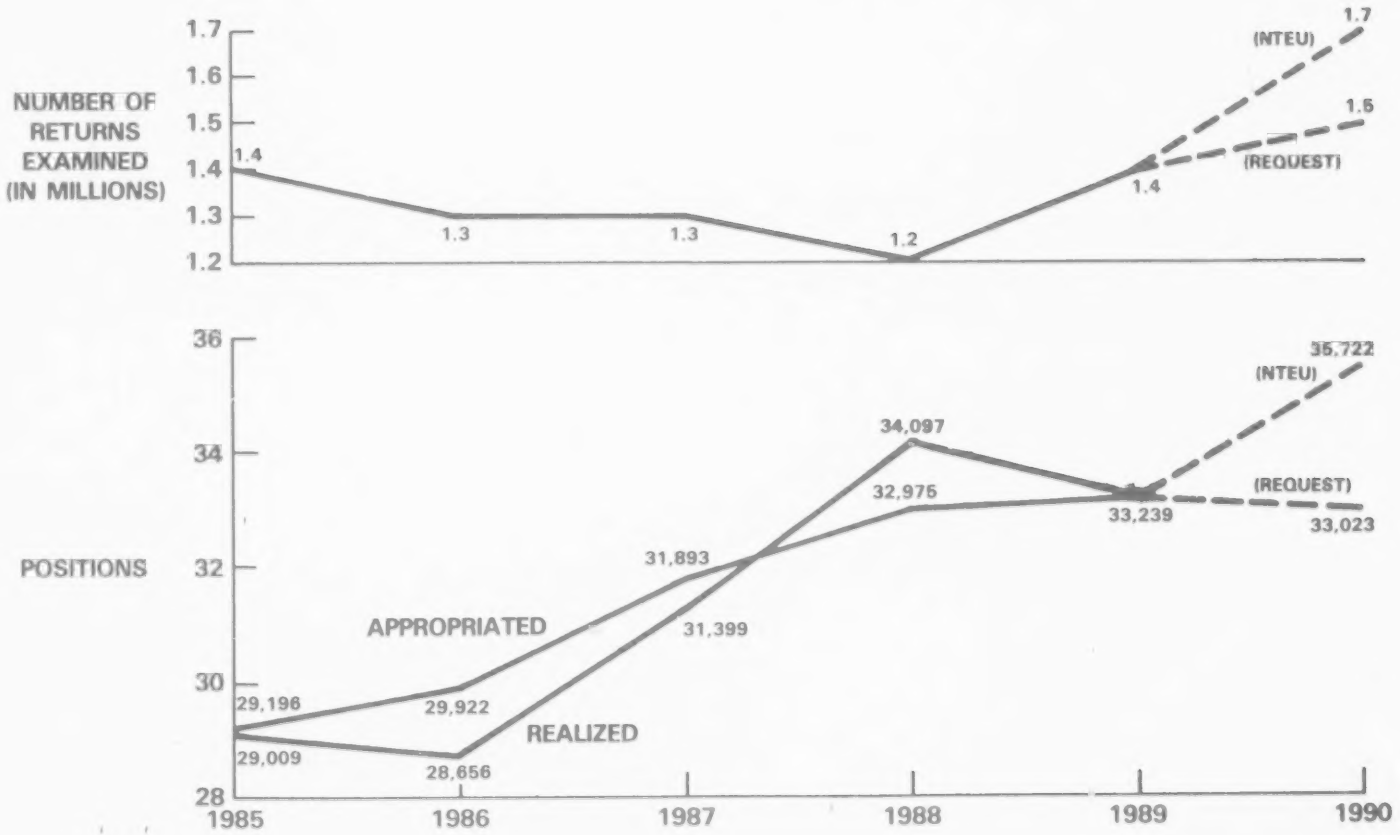
RETURNS PROCESSING



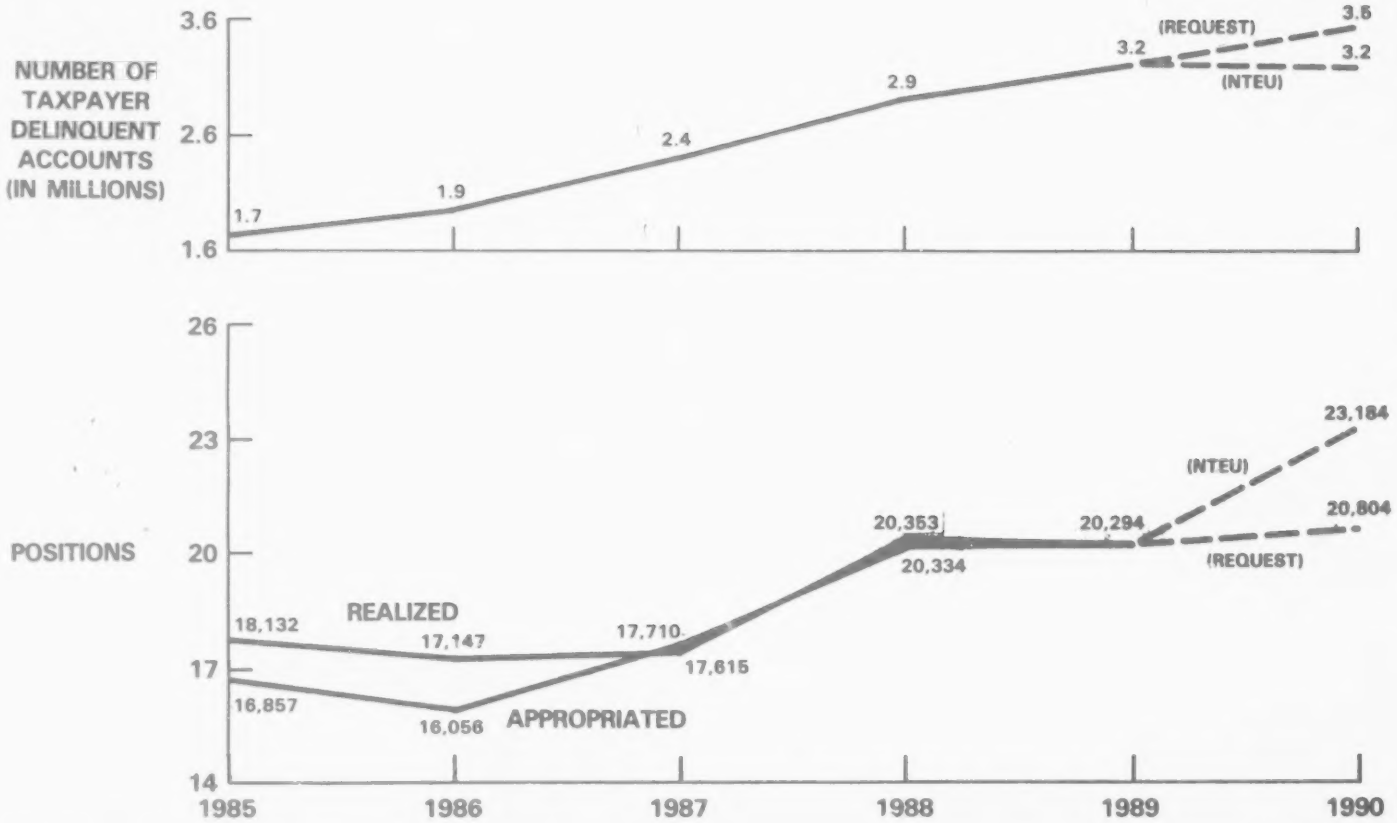
TAXPAYER SERVICE



EXAMINATION



COLLECTION


NUMBER OF TAXPAYER DELINQUENT ACCOUNTS (IN MILLIONS)
3.6
2.6
1.6
1.7
1.9
2.4
2.9
3.2
(REQUEST)
3.5
3.2
(NTEU)
POSITIONS
26
23
20
17
14
18,132
17,147
17,710
17,615
16,857
16,056
REALIZED
APPROPRIATED
20,353
20,334
20,294
23,184
(NTEU)
20,804
(REQUEST)
1985
1986
1987
1988
1989
1990

Mr. DORGAN. Mr. Tobias, thank you very much for your testimony. The charts that you have provided are very useful to us and I think represent a visual display of a lot of the numbers that we have been hearing about this morning. I might just select a couple of areas. The chart that you provided on examinations is interesting.

We are concerned about the declining number of audits. I understand that when you talk about audit, there is a whole range of activities that might be included. But nonetheless, we are concerned about the number of returns audited in the traditional sense. There does represent, it seems to me, an almost irresponsible action on the part of OMB in the examination area.

The Service requested 36,076 positions in examinations. Not only did they not get those positions requested in order to boost the audit rate, they received fewer positions from OMB than currently exists. Then the Office of Management and Budget has the audacity to suggest to us that with fewer people we will actually increase the audit rate. We are not stupid here on Capitol Hill. At least my judgment is that we can understand these charts and understand some basic logic here. If you have fewer examiners, you are not going to improve the audit rate, you are going to decrease the audit rate. So rather than moving in the right direction, we are moving in the wrong direction.

I think your chart on examination is right on point. We ought to put the administration and OMB's feet to the fire on this and ask them, how on Earth do you expect to sell this to people who live and believe and think? That does not make any sense.

Mr. TOBIAS. Of course, you are preaching to the converted here. But when we talk about the number of examinations, we are talking about the number of actual audits conducted by revenue agents or tax auditors. We are not talking about the activities conducted in service centers which are of a contact type similar to the underreporter program. These numbers represent real audits.

Mr. DORGAN. The other area that you included in some charts that I find interesting is in the area of collections. There was testimony this morning about the increase in accounts receivable. And I had intended to ask and did not, how many accounts are lost irretrievably because of the statute of limitations. I am interested generally in the collection effort by the Internal Revenue Service.

I noticed that the estimate by the end of 1989 is $62.4 billion in accounts receivable. It seems to me that is an area in the IRS budget that needs attention. Again, the requested positions by the Service was 22,951. OMB offers 20,804, which they say is a small increase over current levels. But in my own view, current levels are inadequate.

I just want to say that I think your display of these graphically for the committee is beneficial to us as we go through this process.

Let me ask you a more general question, if I might. I recall from 1981, seated behind President Reagan as the Sun came out when he gave his inaugural speech, his admonition that Government is the problem in America, and recall the difficulties in the Federal service in 1981, 1982, 1983, 1984 when constantly the President was suggesting that those who worked in the public sector were people who could not find jobs in the private sector, and basically slothful,

indolent folks who could not find another place to perch. My impression was that that had a dramatic impact on morale in the Federal service.

I think some of that has recovered in the last several years. But how is morale these days among your membership and specifically at the Internal Revenue Service?

Mr. TOBIAS. I think that it is a very serious problem with morale. I think it is reflected in the attrition rates. There has been much testimony that the attrition rates are down. But I think that when you look at it overall that masks problems in particular areas.

I was in Boston not so long ago where I was told that 100 percent of the taxpayer service representatives turned over last year. Now, how can we possibly provide service to the public with trained people if 100 percent turn over due to pay problems.

I was in the Manhattan district of the Internal Revenue Service and was told that 39 percent of the entire work force turned over last year. Now that is a piece of institutional knowledge that just walked out the door, represents tremendous Government investment that walked right out the door, because people believe that they are not going to be properly recompensed and that the opportunities for training and future development are just not available.

So there is, in my view, a real problem with morale. I think is it made worse because—Commissioner Gibbs made a very valiant attempt to increase the quality of what the IRS turns out to its customers. Yet right now with the 1989 budget crunch coming and the prospect of RIF's, and the prospect of squeezing to increase quality, there is a real risk that all that Commissioner Gibbs has done in the past 2½ years will be washed away.

So I think that there is a great deal of apprehension and a great deal of problem with the morale among Internal Revenue Service employees today.

Mr. DORGAN. I might also observe that it is now April, 5 months after the President was elected and understood that he was going to run this Government, and we do not yet have an IRS Commissioner. I think that is unfortunate. I think every organization loses something by these delays we see, not just in this area, but especially in this area. I would like to hope that in the longer term we would have openings like that filled as quickly as possible.

I have complimented Commissioner Gibbs enough and he does not need it any more having left the public sector. But I think that there are some changes that have occurred in the last several years that have been very beneficial and very helpful to try and instill some pride in the work force.

Mr. TOBIAS. I agree with that.

Mr. DORGAN. Part of that is Commissioner Gibbs' responsibility. I, frankly, think that George Bush's inaugural statement and other public statements about the Federal work force have been very helpful. At least it has turned a major corner in suggesting that finally the public workers are people engaged in very worthy public service. That is a delightful change.

Now the question is, are we ultimately going to put the resources there that are necessary to assure a stable work force of qualified, dedicated people who can count on a long term career that is beneficial to them. I do not know the answer to that at this point.

Mr. TOBIAS. I certainly agree that President Bush has used the rhetoric of recognizing the problems of Federal employees. But so far his proposals have fallen way short, particularly as they impact on Federal employees, where we have been asked to shoulder the burden of one-third of the deficit reduction sought. A 2-percent pay increase when we are 26 percent behind is truly an insult.

On your other point about the fact that this administration has not yet appointed a Commissioner I think is particularly acute in the Internal Revenue Service where, by design, there is only one political appointee. So there is only—and everyone else there is a career person. So I think it is particularly important that there be a Commissioner who does have not only the contact, the intellectual contact but the political contact. So the absence of that appointment, I think is very acute in the Internal Revenue Service where there is only one political appointee.

Mr. DORGAN. Mr. Tobias, the information you have given us is very thoughtful and useful. Other members of the committee while not here will have access to the information and use of it. We appreciate very much your patience today, and we appreciate your testimony.

Mr. TOBIAS. Thank you very much.

Mr. DORGAN. The hearing is adjourned.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

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